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No. 83-

In the Supreme Court
OF THE
United States

October Term, 1983

National Liberty Life Insurance Company,
Appellant,

vs.

State Board of Equalization,
Appellee.

On Appeal from the Supreme Court of the State of California

JURISDICTIONAL STATEMENT

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QUESTION PRESENTED

Whether application of California's unapportioned gross premiums tax to an out-of-state insurance company is repugnant to the Due Process Clause when:

1. The insurer maintains no offices, property or bank accounts within California, and solicits business only from outside the State by means of the United States mail or advertisements; and

2. The insurer has no employees present within the State but occasionally hires an independent contractor which utilizes representatives in California to perform limited claims investigation activities.

TABLE OF CONTENTS

TABLE OF CONTENTS

Appendix

TABLE OF AUTHORITIES CITED

Cases

Table of Authorities Cited

Cases

Constitutions

Statutes

Rules

Other Authorities

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On Appeal from the Supreme Court of the State of California

JURISDICTIONAL STATEMENT

Appellant, National Liberty Life Insurance Company ("National Liberty"), appeals from the judgment of the Supreme Court of the State of California, which vacated a decision in favor of the taxpayer by the Court of Appeal of the State of California for the First Appellate District ("Court of Appeal"), which had reversed an adverse judgment of the Superior Court of San Francisco City and County ("Superior Court").[1] The California Supreme Court determined that National Liberty's solicitation of California residents by means of mail and advertisements,

[1]This case was consolidated for trial with another action presenting somewhat similar facts, and the Court of Appeal and California Supreme Court coordinated oral argument and filed single opinions as to both cases, captioned as *Illinois Commercial Men's Association v. State Board of Equalization, National Liberty Life Insurance Company v. State Board of Equalization.* Apps. A & B, *infra.* As in the lower appellate courts, National Liberty is separately pursuing this appeal.

together with limited claims investigation occasionally performed on National Liberty's behalf by an independent contractor's representatives present within the State, provided constitutionally sufficient "nexus" to subject National Liberty to the California insurance tax on gross premiums.

Pursuant to Supreme Court Rule 28.1, a Designation of Corporate Relationships pertaining to National Liberty is found at Appendix D below.

OPINIONS BELOW

The opinion of the California Supreme Court (Appendix A) is reported at 34 Cal. 3d 839, 196 Cal. Rptr. 198, 671 P.2d 349 (1983). The opinion of the Court of Appeal (Appendix B) is presently reported at 140 Cal. App. 3d 516, 189 Cal. Rptr. 610 (1983). The memorandum opinion and amendment of the Superior Court (Appendix C) are not reported.

JURISDICTION

The California Supreme Court rendered its opinion and judgment on October 31, 1983, affirming the Superior Court's judgment, from which an appeal to the Court of Appeal had been taken resulting in reversal of the Superior Court judgment. A notice of appeal to this Court (Appendix E) was filed in the California Supreme Court on December 14, 1983. The time within which to docket the appeal in this Court expires on January 30, 1984, and timely docketing has been made. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The relevant provision of the United States Constitution is the Due Process Clause of the Fourteenth Amendment.

Article XIII, section 14⅘ of the California Constitution and section 12201 of the California Revenue and Tax-

ation Code, as in effect during the tax years in issue, are set forth in Appendix F and Appendix G respectively.

STATEMENT OF THE CASE

1. California imposes a tax on foreign insurance companies which are "doing business" in the State based upon the gross premiums derived from California resident insureds. Cal. Const. Art. XIII, § 14⅘; Cal. Rev. & Tax. Code § 12201. The State Board of Equalization has asserted, and the California Supreme Court has agreed, that a foreign insurer having National Liberty's minimal contacts with California is "doing business" in the State within the meaning of the California constitutional and statutory predicates to taxation. This appeal challenges the federal constitutionality of these taxing provisions on the ground that insufficient nexus exists between Appellant and California to sustain jurisdiction to tax under the Due Process Clause of the United States Constitution.

2. National Liberty is a corporation organized and headquartered in the Commonwealth of Pennsylvania. During the years in issue, National Liberty sold accident, health and life insurance by solicitation carried out exclusively through the United States mail or advertisements (commonly referred to as "direct mail" techniques). Stip. ¶ 3.[2] All of the insurance sold by National Liberty to California residents was marketed in this manner through DeMoss Associates, Inc. ("DeMoss"), also a Pennsylvania corporation, which promoted the insurance plans offered by various underwriters. Stip. ¶¶ 22, 28, 29.

Neither National Liberty nor DeMoss maintained any offices in California during the relevant years. Stip. ¶¶ 35, 39. Nor were there physically present in California any

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[2]References are to paragraphs of the Stipulation of Facts ("Stip.") found in the Clerk's Transcript on Appeal at 87-202. This case was presented to the trial court entirely on stipulated facts.

agents, quasi-agents, missionary men, group organizers, existing policyholders or other representatives of National Liberty or DeMoss soliciting customers on their behalf. Stip. ¶¶ 35, 37, 38, 39, 41. Neither National Liberty nor DeMoss held any fee, leasehold or security interest in property in California, or maintained any accounts with any bank or savings and loan located in California. Stip. ¶¶ 35, 36, 39, 40.

Prior to acceptance or rejection, a prospective customer's application for an insurance policy solicited by DeMoss and underwritten by National Liberty was processed without any investigation, other than a review of the application. Stip. ¶ 52. When a claim arose under a policy, National Liberty was generally able to process the claim immediately on the basis of information submitted by the policyholder; approximately 80 percent of all claims were processed within a week without any investigation. In cases where the data submitted was incomplete or unclear, Appellant was usually able to obtain the information necessary to verify the claim through correspondence or by telephone communication with the policyholder, doctor or hospital. In a small number of cases (less than 2 percent of total claims), National Liberty requested the Pennsylvania office of Retail Credit Company ("Retail Credit"), an independent business organization with offices nationwide, to gather further information concerning claims. Retail Credit was authorized only to collect data, not to offer or make settlements.[3] Stip. ¶ 55.

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[3] During 1963 through 1965, Retail Credit used some 175 of its representatives to conduct a total of approximately 153 claims investigations involving California insureds. Stip. ¶ 56. The total amount paid by National Liberty was approximately $3,785, less than $25.00 per "investigation." *Id.*

Only one California claim was litigated during the years in issue; this case was dismissed upon settlement for $1,500.00, and resulted in National Liberty's payment of legal fees in the amount of $507.50. Stip. ¶ 67.

Aside from these attenuated contacts with the insured's state of residence, National Liberty conducted its entire insurance business in the Commonwealth of Pennsylvania, including actuarial research and determination of premiums and coverage, claims adjustment and performance of other policy owner services, billing and collection of premiums, investment of reserves, and recordkeeping and general administrative activities. Stip. ¶ 43. The Pennsylvania Department of Insurance exercised comprehensive regulatory jurisdiction over National Liberty, and National Liberty was also liable for Pennsylvania corporate net income taxes, premium taxes, and capital stock taxes. Stip. ¶¶ 5, 6.

3. Prior to May 28, 1968, the California Department of Insurance did not require that a license or certificate of authority be held by foreign insurers operating in the "mail order" manner described above, and National Liberty did not obtain such a license or certificate. During the years in issue, the California taxing authorities also did not require direct mail insurers to pay premiums taxes on insurance written for California residents, and no such taxes were paid by Appellant. In 1968, retroactive liability for unpaid premiums taxes for prior open years was asserted by the State pursuant to Article XIII, section 14⅘ of the California Constitution (now section 28) and California Revenue and Taxation Code section 12201, and Appellant paid such taxes for 1963 to 1965.

4. National Liberty commenced this refund action on September 1, 1972 in the Superior Court of the State of California for the City and County of San Francisco. The complaint was based upon, and incorporated, a claim for refund involving the years 1963 to 1965 previously filed by National Liberty and denied by the California

State Board of Equalization. The claim demanded a refund upon the ground, *inter alia,* that California is prohibited from taxing National Liberty under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.[4] National Liberty raised its claim that Article XIII, section 14⅘ of the California Constitution and its implementing counterpart California Revenue and Taxation Code section 12201 are repugnant to the Due Process Clause in the earliest stages of the California refund procedure and throughout the ensuing litigation. All three California courts considering the case ruled directly upon Appellant's federal constitutional claim; the Court of Appeal agreed that California's taxation of National Liberty was constitutionally proscribed, and the California Supreme Court specifically rejected such claim in affirming the Superior Court's judgment. App. A, *infra,* A-13; App. B, *infra,* A-39; App. C, *infra,* A-48.

THE QUESTION PRESENTED IS SUBSTANTIAL

The question presented in this case is so substantial as to merit plenary consideration by this Court for two reasons.

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[4] By virtue of the McCarran-Ferguson Act, 15 U.S.C. § 1011-1015, 59 Stat. 33, insurance companies are not entitled to assert Commerce Clause objections to a state's exercise of regulatory or taxing jurisdiction; however, the vitality of other constitutional protections is not affected. *Western and Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. 648 (1981). Decisions involving the Commerce Clause (discussed below) are nonetheless relevant in assessing jurisdiction to tax insurers. While Commerce Clause protections are broader concerning, *e.g.*, multiple taxation or discriminatory taxation of interstate commerce, the basic jurisdictional predicate of nexus, and the necessary relationship of state benefits to the taxpayer, apply virtually indistinguishable tests under the two constitutional provisions. *See National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756 (1967).

First, the decision of the California Supreme Court incorrectly decides important constitutional questions which are squarely presented in this case. Notwithstanding the superficial recitation by the court below of the constitutional limitations on taxing jurisdiction enunciated in *National Bellas Hess, Inc. v. Department of Revenue,* 386 U.S. 753 (1967), the decision below cannot be reconciled with that established Supreme Court precedent. Moreover, the decision below seriously misinterprets *Scripto, Inc. v. Carson,* 362 U.S. 207 (1960), as authorizing wholesale recharacterization of true independent contractors as the agents of an out-of-state seller for purposes of determining nexus, and consciously disregards the teaching of *Miller Brothers Co. v. Maryland,* 347 U.S. 340 (1954), that mere ancillary in-state activities alone, even if performed by true agents or employees, will not suffice to confer state taxing power over an out-of-state seller. The correct analysis under these prior cases requires a substantial nexus between the taxing state and the entity itself, evidenced by regular and systematic activities within the state, in order to sustain jurisdiction to tax.

Second, if California is permitted to ignore the constitutional protections of *National Bellas Hess,* no safeguard will remain against extraterritorial gross receipts taxation of the nation's substantial industry of mail order sellers.[5]

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[5]The Court has recently agreed to consider another case raising related issues concerning state jurisdiction to tax the gross receipts of an out-of-state seller. *Armco, Inc. v. Hardesty,* 303 S.E. 2d 706 (W.Va. 1983), *prob. juris. noted,* 52 U.S.L.W. 3449 (U.S. Dec. 12, 1983) (No. 83-297). *Armco* involves a different aspect of the nexus issue in that one line of Armco's business (coal mining) was unquestionably present in the state, and the issue presented relates to the taxability of a second line of business which made sales of goods manufactured outside the state to wholesalers within the state. While it is unlikely that *Armco* would directly affect the instant case, the continued vitality of long-standing Supreme Court precedents regarding due process requirements for state taxing jurisdiction is at issue in both cases.

I

THE DECISION BELOW IS IN IRRECONCILABLE CONFLICT WITH PRIOR DECISIONS OF THIS COURT

A. The Constitutional Principles Of Jurisdiction To Tax, Enunciated In National Bellas Hess, Proscribe California Taxation Of A Mail Order Business Having No Outlets, Solicitors Or Property Within The State.

In this case, the State of California asserts its power to levy an unapportioned gross premiums tax on National Liberty, an out-of-state mail order insurer. The decision below upholds the State's jurisdiction to tax by imparting determinative constitutional significance to sporadic claims investigation activities performed within the State by an independent contractor's representatives on National Liberty's behalf. This decision is in irreconcilable conflict with *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), which establishes constitutional immunity from state taxation for out-of-state mail order sellers having no significant contacts with the taxing state.

Under the due process test for sustaining state jurisdiction to tax, "[t]he simple but controlling question is whether the state has given anything for which it can ask return." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). The state's provision of a market to an out-of-state seller, and state benefits accruing to the seller's in-state customers, will not suffice. In order to invoke the constitutional *quid pro quo* of state taxation in exchange for benefits and protections provided to the taxpayer, the Due Process Clause requires demonstrated *presence* of an out-of-state enterprise within the taxing jurisdiction. *National Bellas Hess; Standard Pressed Steel Co. v. Department of Revenue*, 419 U.S. 560 (1975). The due process test has also been phrased as requiring a "definite link, some minimum connection" between the activities of the foreign taxpayer

and the taxing state. *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-345 (1954). Again, this "definite link" must be predicated upon the actual presence in the taxing jurisdiction of the company to be taxed, either through a place of business, employees or soliciting agents. *Miller Brothers; Scripto, Inc. v. Carson*, 362 U.S. 207 (1960); *National Geographic Society v. California Board of Equalization*, 430 U.S. 551 (1977).

The degree of presence necessary to sustain state taxation in the case of mail order sellers is described in *National Bellas Hess*, a case which considered the validity of Illinois' imposition of a use tax collection duty upon a foreign retailer.[6] Although National Bellas Hess engaged in substantial mail solicitation of Illinois residents on a regular basis and derived significant profits from ensuing sales, this Court held that the state did not contribute anything to that company's business activities to support the tax therein at issue. The continuing vitality of the rule

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[6]While *National Bellas Hess* involved a state's attempt to impose upon an out-of-state seller the duty to collect a use tax (the technical incidence of which is on the in-state consumer), it is directly relevant because a failure to satisfy the level of contacts required in a use tax case *a fortiori* determines the infirmity of a general revenue measure, such as the instant gross receipts tax, for which even stronger due process justification is required. This point was recently stressed in *National Geographic Society*: "[Compared to direct taxes] [t]he case for validity of the imposition upon the out-of-state seller enjoying such services of a duty to collect a use tax is even stronger . . . ." 430 U.S. at 558.

Thus, the use tax cases cited herein all state the *minimum* jurisdictional standard which could be applicable in assessing the constitutionality of a gross premiums tax. Moreover, even among direct taxes, a gross receipts tax such as the California tax of 2.33% levied on gross premiums (regardless of net income or loss of the insurer) demands a heightened level of contacts to justify the onerous nature of exaction. *See generally Norton Co. v. Department of Revenue*, 340 U.S. 534 (1951); *General Motors Corp. v. Washington*, 377 U.S. 436 (1964).

requiring soliciting agents, property or an office to support taxing jurisdiction was declared by Justice Stewart:

> In order to uphold the power of Illinois to impose use tax burdens on National in this case, we would have to repudiate totally the sharp distinction which these and other decisions have drawn between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business. But this basic distinction . . . is a valid one, and we decline to obliterate it.

386 U.S. at 758 (citations omitted). Thus, the *National Bellas Hess* decision stands for the principle that a company which is not domiciled in a state, does not employ solicitors to generate business within the state, and has no property or office therein cannot constitutionally be taxed by such state.

This requirement that the taxpayer be present within the state to support taxing jurisdiction is also apparent from cases involving insurance of in-state property by out-of-state companies. *See, e.g., State Board of Insurance v. Todd Shipyards Corp.*, 370 U.S. 451 (1962); *Connecticut General Life Insurance Co. v. Johnson*, 303 U.S. 77 (1938). These cases establish that the requisite presence of the taxpayer-insurer cannot be established by proxy; that is, the mere presence of the insured individual or risk property within the state (and consequent benefits from state protection of such person or property) will not suffice.[7] *Id.*

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[7]Earlier decisions of this Court determining whether jurisdiction exists to tax an out-of-state insurer give similar emphasis to analysis of the insurer's presence within the state. *See, e.g. Allgeyer v. Louisiana*, 165 U.S. 578 (1897); *St. Louis Cotton Compress Co. v. Arkansas*, 260 U.S. 346 (1922); *Compañia General de Tabacos de Filipinas v. Collector of Internal Revenue*, 275 U.S. 87 (1927).

National Bellas Hess was recently reaffirmed in *National Geographic Society v. California Board of Equalization*, 430 U.S. 551 (1977), a case involving application of the California use tax to a mail order seller. Consistent with *National Bellas Hess*, the Court's opinion in *National Geographic Society* relies upon a substantial presence of the mail order company within the state (offices and employees soliciting business therefrom) in order to sustain jurisdiction to tax. The California Supreme Court's novel theory that a "slightest presence" will suffice is specifically disavowed:

> Our affirmance . . . is not to be understood as implying agreement with that court's "slightest presence" standard of constitutional nexus. [National Geographic's] maintenance of two offices in the State and solicitation by employees assigned to those offices of advertising copy in the range of $1 million annually . . . establish a much more substantial presence than the expression 'slightest presence' connotes.

430 U.S. at 556.

In the instant case, National Liberty had no "retail outlets, solicitors or property within [the] State" that would support taxing jurisdiction under the standard articulated in *National Bellas Hess*. 386 U.S. at 758. Appellant submits that, despite suggestions to the contrary in the opinion below (App. A, *infra*, A-12), the California Supreme Court has reverted to its old "slightest presence" test in applying *National Bellas Hess* to the instant case. The decision below therefore improperly constricts due process protections against extraterritorial taxation accorded out-of-state sellers under *National Bellas Hess*.

B. Scripto v. Carson Does Not Authorize Imputing The In-State Activities Of True Independent Contractors To An Out-Of-State Seller.

The California Supreme Court's opinion cites no cases which authorize state taxing jurisdiction over an out-of-state seller based upon utilization within the state of true independent contractors.[8] Indeed, only one case is found in which the facts relating to employment status are sufficiently extreme as to warrant treating so called "independent contractors" in the same manner as employees for purposes of determining an out-of-state seller's presence within the state. *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960). The California Supreme Court's decision turns the result reached under the circumstances presented in *Scripto* into a general rule of sweeping application which simply cannot be reconciled with established Supreme Court precedent.

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[8]In fact, California authority is to the contrary, at least where the State itself benefits from the conclusion that sales through independent contractors do not provide jurisdiction to tax. *Irvine Co. v. McColgan*, 26 Cal. 2d 160, 157 P.2d 847 (1945) (sales of California products into other states through the use of independent contractors held not to provide such states with jurisdiction to tax; therefore, out-of-state receipts remained subject to tax in California). In *Irvine*, the court specifically recognized that "[t]ransactions engaged in *for* a foreign corporation in a State are not necessarily engaged in *by* the corporation in that State." 26 Cal. 2d at 165. *See also American President Lines, Ltd. v. Franchise Tax Board*, 3 Cal. App. 3d 587, 83 Cal. Rptr. 702 (1970) (independent contractor which acts on behalf of the United States within California cannot treat its own acts as those of the Government, where the Government would be exempt from franchise tax).

See also Public Law 86-272 § 381, 73 Stat. 555 which prescribes limitations on a state's ability to levy a net income tax as a result of solicitation activities. The law denies state tax jurisdiction based solely on the presence within the state of independent contractors acting on behalf of an out-of-state seller.

In *Scripto,* this Court's approval of jurisdiction to tax rested upon continuous and systematic solicitation activities conducted within the state by ten resident salesmen. It is apparent that the salesmen in *Scripto* were considered the equivalent of employees on the facts of that case, despite their denomination as "independent contractors" in the written contracts that each had with Scripto. The contracts specified a particular territory to be serviced by each salesman, and required that each sales order was to be signed by the solicitor as "salesman." The salesmen were furnished with catalogues, samples, and advertising material by Scripto. Based upon these facts, the salesmen were considered to be actively engaged in business in Florida as representatives of Scripto "for the purpose of attracting, soliciting and obtaining Florida customers." 362 U.S. at 209.

By contrast, the use of an independent contractor relied upon by the California Supreme Court in this case involved a completely independent entity, Retail Credit Company, which used its own representatives in California to gather extremely limited claims information on behalf of National Liberty. National Liberty's contact with Retail Credit, a commercial investigation service with nationwide offices, was through Retail Credit's Pennsylvania office.[9] Unlike *Scripto,* no privity of contract ever existed between National Liberty and any individual representatives employed in California by Retail Credit. On this completely attenuated connection, the California court's conclusion is the equivalent of predicating jurisdiction on the use by an out-of-state seller of an independent nationwide organization such as Dun & Bradstreet to obtain credit information regarding potential customers.

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[9]As of December 31, 1966, Retail Credit had 12,421 employees in 312 branch offices and 1,438 sub-offices nationwide. Moody's Industrial Manual (1967) at 1841.

Scripto properly recognizes that state taxing jurisdiction cannot be circumvented by the mere choice of label attached to a *de facto* employee. However, the decision below mistakes this Court's willingness to recharacterize independent contractors ***under appropriate circumstances*** for blanket authority to predicate taxing jurisdiction on ***any*** use of true independent contractors within the state.[10] In fact, this Court has subsequently recognized that *Scripto* represents "the furthest constitutional reach to date of a State's power to deputize an out-of-state retailer as its collection agent for a use tax." *National Bellas Hess,* 386 U.S. at 757. In the instant case there are simply no compelling facts to justify application of such an exceptional doctrine in lieu of the general protections mandated by *National Bellas Hess,* as the Court of Appeal correctly recognized.[11]

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[10]The weakness of the California Supreme Court's view is particularly illustrated by reference to the constitutional requirement that the state provide the taxpayer with sufficient benefits to support the *quid pro quo* exaction of a tax. As this Court recently emphasized, the benefits inquiry must be applied between the state and the "*person* . . . it seeks to tax." *National Geographic Society,* 430 U.S. at 561. That decision also clearly evaluated the benefits provided by the state (such as police and fire protection) in terms of benefits supplied directly to the *taxed person's* office or agents. *Id.*

[11]The Court of Appeal's opinion concludes that:

> We recognize that labeling individuals as "independent contractors" is of no constitutional significance if they in fact function as salesmen in a state soliciting and securing a substantial flow of business for a foreign company. (See *Scripto v. Carson, supra,* 362 U.S. at p. 211.) In these cases, however, the independent contractors had absolutely no part in the solicitation of insurance for either company, and their activities were of relatively little overall significance in the conduct of either company's business. . . . Between 1963 and 1965, about 98 percent of [National Liberty's] claims were processed without investigator assistance in this state. We view the occasional activities in this state of independent contractors on behalf of these

(continued)

C. Mere Ancillary Or Occasional Contacts With A State, Particularly Those Which Do Not Involve Solicitation Of Business, Will Not Create Nexus To Tax An Out-Of-State Seller Under Miller Brothers v. Maryland.

Even if the California Supreme Court were correct in treating Retail Credit's presence within the State as attributable to National Liberty for purposes of testing jurisdiction to tax, the occasional and incidental information-gathering activities of the independent contractor within California provide too slender a reed upon which to base the substantial nexus with and concommitant benefits to the *taxpayer* required by the Due Process Clause. Predicating tax jurisdiction upon so slight a presence squarely conflicts with prior decisions of this Court which require regular and systematic in-state activities of the taxpayer, especially those of a business-generating nature.

Particularly egregious is the California Supreme Court's dismissal of *Miller Brothers Co. v. Maryland*, 347 U.S. 340 (1954) as "so clearly distinguishable" that discussion of its application to this case would "serve no useful purpose." App. A, *infra*, A-15. In fact, *Miller Brothers* extends the constitutional immunity from imposition of a use tax collection duty afforded to mail-order sellers under *National Bellas Hess* to circumstances in which even *substantial* ancillary activities within the state are present. As the standard for sustaining gross receipts taxation is even stricter, failure to demonstrate more substantial contacts in this case than were present in *Miller* serves *a fortiori* to render California's assertion of taxing jurisdiction over Appellant unconstitutional. *See* note 6, *supra*.

> companies as akin to those which the Supreme Court by implication found constitutionally insignificant in *Nat. Bellas Hess*, and conclude that they were insufficient to establish the minimum link necessary to make the state's tax permissible.

App. B, *infra*, A-38.

In *Miller Brothers*, a 1954 decision reaffirmed in *National Bellas Hess*, this Court held that the State of Maryland could not require a Delaware retailer, which solicited Maryland customers through the mail and advertisements, to collect a use tax with respect to shipments into Maryland *even though the taxpayer delivered some two-thirds of the goods sold to Maryland customers into the state in its own trucks operated by its own employees.* 347 U.S. at 350-51. As *Miller Brothers* holds that even such substantial ancillary activities within the state will not necessarily suffice to trigger taxing jurisdiction, the case for immunity for the occasional and incidental claims verification activities presented in this case is even clearer.[12] Appellant submits that the decision below fails to discuss *Miller Brothers* because that case cannot be squared with the expansive notions of state taxing jurisdiction that the California Supreme Court engrafts onto *National Bellas Hess.*

Miller Brothers was recently cited in *National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 558-559 (1977), where this Court once again relied upon substantial presence within the state to satisfy the nexus requirement for imposing a use tax collection duty on a mail order seller. In upholding jurisdiction, this Court

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[12]The court below bases its finding of nexus upon the use of independent contractors within the state for purposes of "application, verification and claims procedures" (App. A, *infra*, A-11) and "investigation and/or settlement" (App. A, *infra*, A-12). The decision below therefore appears to rely on three types of contacts to support jurisdiction: verification of applications, verification/investigation of claims, and settlement of claims by claims adjustors. However, it should be noted that *two* of these *three* contacts (independent contractors investigating applications and settling claims) relate *only* to the case coordinated with National Liberty's for argument, *Illinois Commercial Men's Association v. State Board of Equalization*. Appellant's Stipulation of Facts clearly states that National Liberty did not investigate applications and never empowered Retail Credit to settle claims. Stip. ¶¶ 52, 55.

specifically rejected the lower court's notion that only a "slightest presence" is constitutionally required. 430 U.S. at 556, quoted in pertinent part at 11, *supra*.

Instead of according due weight to *Miller Brothers*, the decision below relies upon *Scripto* but fails to recognize the *extent* requirement of the due process test enunciated therein, which clearly indicates the need for substantial contacts beyond the level present in this case. In *Scripto*, this Court simply concluded that *continuous* and *systematic* use of ten so-called independent contractors *to solicit business within the state*, under the circumstances presented in that case, rose to a level of constitutional significance for purposes of taxing jurisdiction. As noted previously, the fact that this extreme conclusion is intended to be given very restrictive application was emphasized by the Supreme Court in *National Bellas Hess*, where the Court referred to *Scripto*, a *use* tax case, as the "furthest constitutional reach to date of a state's power to deputize an out-of-state retailer as its collection agent for a use tax." 386 U.S. at 757. Moreover, the Court's opinion in *Scripto* recognizes that jurisdiction is particularly justifiable where a use tax collection duty is imposed, in that the out-of-state concern itself "is charged with no tax . . . ." 362 U.S. 211.[13]

Aside from the minimal *extent* of in-state activities in the present case, the incidental *nature* of claims verification activities, whether performed by an independent contractor recognized as such or (as the court below concluded) by "agents" whose presence is attributable to National Liberty, distinguishes the instant situation from the solicitation of business which was of primary importance in

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[13]*See also National Geographic Society*, which upheld a *use* tax collection duty where the taxpayer had unrelated offices within state, recognizing and distinguishing *Norton Co. v. Department of Revenue*, 340 U.S. 534 (1951), which struck down a *gross receipts* tax even though taxpayer had unrelated facilities within state.

Scripto. 362 U.S. at 212. The heightened constitutional emphasis on in-state activities which create or maintain the business-generating capacity of an out-of-state seller, as contrasted with the less significant (and limited) claims verification present in this case, is reflected in numerous decisions of this Court. *See, e.g., Scripto; National Geographic Society; Standard Pressed Steel Co. v. Department of Revenue*, 419 U.S. 560 (1975); *General Motors Corp. v. Washington*, 377 U.S. 436 (1964).[14]

Rather than analyzing the pertinent facts in *Miller Brothers*, the decision below discusses and claims to find support in *Standard Pressed Steel Co. v. Department of Revenue*. In fact, this Court's decision in that case was based upon regular and systematic activities within the state of a full-time resident employee aimed at facilitating a continuing sales relationship with a major customer. Thus *Standard Pressed Steel* is distinguishable from the instant

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[14] Although counsel is unaware of any explicit statement by this Court to the effect that follow-up activities within a state are less important than solicitation in conferring state tax jurisdiction over a seller, the conclusion that business-generating contacts are of primary concern is implicit from the emphasis given this contact in the cited decisions.

Moreover, it is commercially reasonable to assume that other incidental concomitants of an out-of-state seller's relationship with customers exist in most decided cases. For example, Justice Fortas in his dissent in *National Bellas Hess* tacitly recognized the presence of such contacts in that case:

> A substantial part of Bellas Hess' sales is on credit. Its catalogue features "NBH Budget Aid Credit"—which requires no money down but requires the purchaser to make monthly payments which include a service fee or interest charge, and which also incorporates an agreement, unless expressly rejected by the purchaser, for "Budget Aid Family Insurance."

386 U.S. at 761. Moreover, as Justice Fortas also concluded, it must be assumed that National Bellas Hess sold its delinquent accounts or took measures to collect them in Illinois. 386 U.S. at 762.

case in each critical respect outlined above, i.e., extent of contact (by genuine employees) and nature of activity undertaken within the state.[15] Similarly misplaced is the reliance below on this Court's dismissal of appeals in *Ministers Life and Casualty Union v. Haase,* 30 Wis. 2d 339, 141 N.W.2d 287, *appeal dismissed,* 385 U.S. 205 (1966), and *Armed Forces Cooperative Insurance Association v. Department of Insurance,* 622 P.2d 1318 (Wyo. 1980), *appeal dismissed,* 454 U.S. 1130 (1982). In each of these cases, significant continuous presence within the state for solicitation purposes was established; indeed, in a mutual benefit insurance association such as that involved in *Armed Forces,* the resident insured parties are recognized as realistically constituting the insurer itself. *See* 622 P.2d at 1343, quoting *Hoopeston Canning Co. v. Cullen,* 318 U.S. 313 (1943).

In summary, Appellant submits that California has demonstrated *neither* substantial presence within the State *nor* any direct benefits to the taxpayer sufficient to invoke the constitutional *quid pro quo* of taxation, particularly in the form of a gross receipts levy. The California court has

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[15]This Court concluded that the full-time employee "made possible the realization and continuance of valuable contractual relations" between the taxpayer and its in-state customer, based upon the fact that the employee's activities were necessary

> . . . in making [the taxpayer] aware of which products Boeing might use, in obtaining the engineering design of those products, in securing the testing of sample products to qualify them for sale to Boeing, in resolving problems of their use after receipt by Boeing, in obtaining and retaining good will and rapport with Boeing personnel, and in keeping the invoicing personnel of appellant up to date on Boeing's lists of purchasing specialists or control buyers.

419 U.S. at 561. The Court also rested its decision on the regular presence within the state of a group of the taxpayer's engineers to visit the same client. *Id.*

surpassed any constitutional pronouncement to date in authorizing state jurisdiction to tax mail order sellers; if its decision is permitted to stand, the teaching of *Miller Brothers* and *National Bellas Hess* is effectively obliterated.

II

THE DECISION BELOW RESULTS IN A SIGNIFICANT EXPANSION OF STATE TAXING POWER OVER MAIL ORDER SELLERS

Realistically, it must be recognized that the ultimate thrust of California's assertion of tax liability in this case is that an out-of-state company must pay a toll to the State just for the privilege of selling any type of product to its residents.[16] This rationale, however, is simply the disguised application of an extraterritorial tax—here the particularly onerous gross receipts tax—which is clearly proscribed under the Due Process Clause of the Constitution.

In 1967, the year in which *National Bellas Hess* was decided, mail order sales nationwide constituted a $2.4 billion industry annually; today, it is estimated that the amount of such sales has grown approximately fifteen-fold.[17] Given recent pressures on state taxing authorities to discover new sources of revenue, mail order sellers represent obvious and attractive candidates for expansion

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[16]Indeed, the court below expressly rejected a narrower ground of decision when it was offered. Notwithstanding the State Board of Equalization's persistent efforts to argue that constitutional authorities relating to sales outside the insurance industry are irrelevant to this case, the California Supreme Court (as well as the Court of Appeal) properly rejected this contention and recognized the precedential force of *National Bellas Hess* for all types of mail order sellers. App. B, *infra*, A-8 to A-9.

[17]*See National Bellas Hess*, 386 U.S. at 763; The Economist, Oct. 22, 1983, at 81 (U.S. ed. at 77).

of state tax bases. However, such enthusiasm for new taxpayers is not constitutionally boundless. The Due Process Clause imposes limitations on this appetite for revenue, requiring demonstrated *presence* within the taxing jurisdiction and a constitutional *quid pro quo* of state benefits and protection to the taxpayer as a prerequisite to taxation. It is perhaps not surprising that state taxing authorities have become increasingly aggressive in testing the bounds of such limitations, or even that state courts are often less sensitive than this Court in enforcing constitutional restrictions. *See, e.g., Diamond National Corp. v. State Board of Equalization*, 49 Cal. App. 3d 778, 123 Cal. Rptr. 160 (1975), *rev'd per curiam*, 425 U.S. 268 (1976); *National Geographic Society*, 430 U.S. at 556 (rejecting California's "slightest presence" test). Therefore, continued access to this Court for final review is necessary if federal constitutional parameters on state taxing jurisdiction are to have any meaning.

Appellant submits that the California Supreme Court's decision predicates taxation on the barest of contacts, thereby undermining the vitality of due process protections for all types of mail order sellers. The fundamental principles of state taxing jurisdiction developed in *National Bellas Hess*, *Scripto*, and *Miller Brothers* will be substantially eroded, and other states led to transgress established constitutional boundaries, if the decision below is granted the imprimatur of this Court's dismissal of appeal.

CONCLUSION

For these reasons, the Court should note probable jurisdiction of this appeal.

Dated: January 28, 1984

Respectfully submitted,

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Appendix A

In the Supreme Court of the State of California

S.F. 24557

Illinois Commercial Men's Association,
Plaintiff and Appellant,

v.

State Board of Equalization,
Defendant and Respondent.

National Liberty Life Insurance Company,
Plaintiff and Appellant,

v.

State Board of Equalization,
Defendant and Respondent.

[Filed Oct. 31, 1983]

We are asked to determine whether California may impose a tax on gross premiums collected by foreign insurers who solicit business in California by mail from outside the state, and who utilize independent contractors in California to perform functions incident to the acceptance of applications and the administration of claims. The significant element in making this determination is whether the contacts between the insurers and the state justify imposition of the tax under the due process clause of the Fourteenth Amendment to the United States Constitution.

Plaintiffs, Illinois Commercial Men's Association (IC) and National Liberty Life Insurance Company (NL) are organized in other states and each has its principal place of business in the state in which it is incorporated. Both companies sold accident, health, and life insurance policies in California by advertising in national publications and by direct mail solicitation of prospective customers. NL advertised in local publications as well. Neither plaintiff owned or leased property in California or employed agents or representatives to solicit business in this state. However, independent contractors acting on their behalf did perform certain acts in California in connection with the administration of claims and other matters. These activities will be described in detail below.

In 1965, the State of California for the first time made the assertion that unlicensed foreign insurers were subject to regulation by the state. NL obtained a certificate and license from the Department of Insurance (department) in August 1968. IC has never sought a license or certificate from the department, and has ceased to solicit business in California.

In May 1968, the department notified plaintiffs of its intention to assert their liability for the payment of a gross premium tax for the years 1963 through 1967, pursuant to article XIII, section 14⅘ of the California Constitution (now § 28), and Revenue and Taxation Code section 12201. These measures impose an annual tax on insurers "doing business in this state." Prior to this time, the state had not attempted to assess against plaintiffs a tax attributable to premiums received for direct mail insurance sold to California residents. The State Board of

Equalization (board) assessed gross premium taxes of $23,504.54 against IC for the years 1963 through 1967, and $47,747.50 against NL for the years 1963 through 1965. Plaintiffs paid the tax and filed claims for refund pursuant to sections 12978 and 12979 of the Revenue and Taxation Code.[1] The claims were denied, and these actions against the board seeking refunds followed. The trial court found in the board's favor, holding that the tax was justified in part on the ground that plaintiffs received a benefit from California by virtue of health and police services provided to their insureds. These services promoted the well-being of the insureds, reasoned the trial court, thereby improving "the odds on which the plaintiff insurers are gambling" by their issuance of policies to California residents. Plaintiffs appeal from the ensuing judgment.[2]

The United States Supreme Court has considered the circumstances under which a state may, within the limits of the due process clause, impose a tax on a foreign corporation that conducts its business by mail from outside the taxing state. Generally speaking, the taxing state must have a substantial interest in the transactions in order to justify imposition of the tax. This interest is measured by the extent and nature of the contacts between the state and the foreign corporation (such as the presence of agents of the corporation within the state), and the benefits conferred on the corporation by the state. (National Bellas Hess v.

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[1]Section 12978 sets forth time limitations on claims for refunds, and section 12979 provides that claims shall be in writing and state the specific grounds upon which they are founded.

[2]Although two separate actions are involved, the issues are similar as to both plaintiffs. Unless otherwise noted, the discussion which follows will be applicable to both.

Dept. of Revenue (1967) 386 U.S. 753, 756 (hereafter *National Bellas*).) (Plaintiffs vigorously contend that they have insufficient contacts with California and derive no benefits from this state to justify imposition of the tax.

Before discussing in detail the standards which allow a state to tax a foreign corporation and their application to the conduct of plaintiffs' business in California, we consider the board's claim that two cases, one decided by this court and one by the United States Supreme Court, have settled the question at issue. The board asserts that People v. United National Life Insurance Company (1967) 66 Cal. 2d 577 (hereafter *United National*) determined that mail order insurers may constitutionally be regulated by California, and that Connecticut General Life Insurance Company v. Johnson (1938) 303 U.S. 77, held a state which has the power to regulate a foreign insurer also has the power to tax it. Thus, the board maintains, it is unnecessary to assess anew the character of plaintiffs' contacts with California to uphold imposition of the tax.

In *United National*, after an exhaustive discussion of the history of state regulation and taxation of foreign insurers under the due process and the commerce clauses, we held unanimously that three mail order insurers (one of them NL), which solicited and negotiated insurance transactions with California residents exclusively by mail from offices located outside the state, could constitutionally be regulated by California.[3]

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[3]*United National* points out (66 Cal.2d 577 at pp. 583-584) that the McCarran Act (15 U.S.C. §§ 1011-1015), as interpreted in Prudential Insurance Company v. Benjamin (1946) 328 U.S. 408, 429-430, excepts state regulation of insurers from the restraints imposed by the commerce clause.

The board insists that this holding applies not only to state regulation of foreign insurers, but also to taxation of such entities. Plaintiffs claim, on the other hand, that contacts between a state and a foreign insurer which would justify regulation or the service of process would not be sufficient to warrant taxation (citing Jeter v. Austin Trailer Equipment Co. (1953) 122 Cal.App.2d 376, 381; Aldens, Inc. v. La Follette (7th Cir. 1977) 552 F.2d 745, 751, fn. 12), and that a foreign corporation may not be taxed by the state unless the state has conferred some benefits on the corporation and the corporation is present in the state.

The board counters with the United States Supreme Court's opinion in Connecticut General Life Insurance Company v. Johnson, supra, 303 U.S. 77, which, it claims, holds that the power to regulate and tax are congruent. That decision held invalid a California tax on premiums paid pursuant to reinsurance contracts entered into in Connecticut between a Connecticut insurer licensed to do business in California and other insurers also licensed here. However, since no act in the formation, performance or discharge of the contracts occurred in this state, and the contracts did not depend on any privilege or protection granted by the state, imposition of the tax was held to violate due process. In the course of its opinion, the court declared, "As a matter of convenience and certainty, and to secure a practically just operation of the constitutional prohibition, we look to the state power to control the objects of the tax as marking the boundaries of the power to lay it. Hence it is that a state which controls the property and activities within its boundaries of a foreign corporation admitted to do business there may tax them." (At

p. 80.)[4] Plaintiffs challenge the board's interpretation of this language; they assert that the statement means only that a state which may not regulate a foreign corporation does not have the power to tax it.

We confess some doubt as to the meaning of the language quoted, but we cannot accept the correctness of the board's claim that the power to regulate a foreign insurer is always determinative of the power to tax it. The United States Supreme Court has applied substantially the same test to determine the validity under the due process clause of a tax on a foreign corporation both before and after its decision in *Connecticut General*. The relationship between the state and the insurer has been examined to determine whether there is "some definite link, some minimum connection, between a state and the person, property or transaction ... [the state] seeks to tax" and whether the state has "given anything for which it can ask return." (*National Bellas*, 386 U.S. 753, at p. 756.)

Although the formulation of the test has varied to some degree, its substance has remained essentially the same in

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[4]The full paragraph in which the statement appears is as follows: "But the limits of the state's legislative jurisdiction to tax, prescribed by the Fourteenth Amendment, are to be ascertained by reference to the incidence of the tax upon its objects rather than the ultimate thrust of the economic benefits and burdens of transactions within the state. As a matter of convenience and certainty, and to secure a practically just operation of the constitutional prohibition, we look to the state power to control the objects of the tax as marking the boundaries of the power to lay it. Hence it is that a state which controls the property and activities within its boundaries of a foreign corporation admitted to do business there may tax them. But the due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere." (At pp. 80-81.)

numerous decisions of the high court. (E.g., Moorman Mfg. Co. v. Bair (1978) 437 U.S. 267, 273 [tax unjustified "unless there is some minimal connection" between the activities of the interstate business and the taxing state]; Standard Steel Co. v. Wash. Revenue Dept. (1975) 419 U.S. 560, 562 ["whether the state has given anything for which it can ask return"]; Scripto v. Carson (1960) 362 U.S. 207, 211-212 ["the test is simply the nature and extent of the activities of the appellant in Florida"]; Wisconsin v. J.C. Penney Co. (1940) 311 U.S. 435, 444 [the question is whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits afforded by the state].) In the insurance context as well, the high court has considered the extent and nature of the contacts between the taxing state and the foreign insurer to determine whether the tax was justified under the due process clause. (E.g., State Bd. of Ins. v. Todd Shipyards (1962) 370 U.S. 451 [foreign insurer which carries on no activities, solicits no business, and has no office or agents in taxing state not subject to taxation].)

Plaintiffs rely heavily on *National Bellas*, supra, 386 U.S. 753, in support of their claim that the tax is invalid as to them. *National Bellas* was decided four days after *United National*, and it involved the validity of a tax imposed by Illinois upon a retailer, not licensed to do business in Illinois, and incorporated outside that state. The retailer sold goods to Illinois residents by means of catalogue solicitations and flyers sent to past and potential customers from outside the state. It did not maintain an office or other place of business in Illinois, had no agents, salesmen, or other representatives there to solicit business or to accept

payment for or deliver or service merchandise which it sold, and it owned no property in Illinois. All its contacts with Illinois residents were by mail or common carrier.

The high court, after stating the applicable test as set out above, held that imposition of the tax violated both the due process and the commerce clauses because a state may not impose a tax "upon a seller whose only connection with customers in the State is by common carrier or the United States mail." It distinguished between mail order sellers who do no more than communicate with customers in the state by such means as a part of a general interstate business, upon whom the tax could not be properly imposed, and sellers with retail outlets, solicitors, or property within the state, which are subject to taxation.

The board claims that *National Bellas* is distinguishable because it held the tax invalid under both the due process and commerce clauses, and because it involved a retailer rather than an insurer. The state has a special interest in insurance matters in view of the nature of insurance and the continuing relationship between the insurer and the state's residents; therefore, claims the board, the standards for state taxation of an insurer are more liberal than those applicable to a retailer. However, the opinion in *National Bellas* considered separately the requirements of the due process and commerce clauses, states that the standards under both provisions are similar, and holds that these provisions were violated by the Illinois tax. Moreover, while it is true that the states have a special interest in the business of insurance, and that interest justifies regulation of an insurer which has lesser contacts with the regulating state than other types of businesses,

we do not agree that this enhanced interest also justifies taxation of a foreign insurer under standards less stringent than those applicable to other enterprises. In fact, as we have seen, the United States Supreme Court applies substantially the same standards to insurers as to other businesses in determining whether a state has the right under the due process clause to tax a foreign corporation. (See, e.g., State Bd. of Ins. v. Todd Shipyards, supra, 370 U.S. 451.)

Thus, we cannot avoid an examination of the relationship between plaintiffs and California to determine whether the tax was justified under the standards set forth above.

The stipulated facts establish the following:

A person interested in purchasing an insurance policy would submit his application by mail to the plaintiffs' home office in another state. If the application was accepted, a contract was formed in the plaintiffs' home state, and a policy was mailed to the applicant.[5] Premiums were paid by mail.

In almost all cases, IC processed applications without investigation, although on an average of five or six times a year, it would request an independent contractor in California to confirm information set forth in an application.

IC sent 648,175 mail solicitations into the state between 1963 and 1965. It issued more than 105,000 policies in California, and approximately 3,318 claims were filed between 1963 and 1967 by California policyholders. When

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[5]NL also conducted solicitations by sending a policy to a prospective customer which could be accepted in California by executing a "validating certificate" and mailing it to the company.

an insured made a claim, IC's practice was to send a form to be completed by the claimant and his physician. Most claims were processed on the basis of these forms, but approximately 10 percent would not be processed until IC received confirming information from independent contractors in California, who collected information from doctors, hospital personnel, or police, and sometimes from the claimant, his family, or his representative.

Ordinarily, IC would pay a claim upon receipt of this additional information, but in certain difficult cases, it would ask another independent contractor in California to obtain confirming data. This contractor had authority to settle claims on behalf of IC. Between 1965 and 1968, 124 California claims were handled in this manner. Two claims resulted in lawsuits in California between 1963 and 1967. IC was represented by California attorneys in the litigation; both suits were ultimately settled.

NL generally processed applications without investigation. It had 885 life insurance policyholders in California between 1963 and 1965, and 38,167 accident and health policyholders. In that period, 7,745 claims were filed by California residents. During the processing of these claims, NL would on occasion request Retail Credit Company in Pennsylvania, an independent organization, to contact its California office to collect necessary data by interviewing doctors, hospital personnel, police, and other persons, and by obtaining copies of documents, such as the reports of doctors and police. Between 1963 and 1965, it utilized Retail Credit Company to collect information in connection with 2 percent of the claims filed. Retail used 175 representatives to conduct about 153 investigations in California on

behalf of NL, which paid approximately $3,785 for these services. This amount represented less than one-third of 1 percent of the premiums collected by NL. Retail was not authorized to offer or make settlements on behalf of NL.

Plaintiffs claim that, like the retailer in *National Bellas,* they have no employees or property in California, and their activities in this state amount substantially to communication with customers by mail. They assert that the application, verification, and claims procedures described above were minimal and sporadic, and were insufficient to justify imposition of the tax. We disagree.

We observe, first, the fact that a foreign corporation performs acts in the taxing state through persons it designates as independent contractors is not determinative of whether the nexus required for taxation is present. In Scripto v. Carson, supra, 362 U.S. 207, the high court considered the imposition of a tax on a foreign corporation by Florida. The corporation had entered into contracts with 10 salesmen who lived in Florida and who solicited orders for the products manufactured by the corporation. They forwarded these orders to the corporation's home office out of the state. The contracts designated each salesman as an "independent contractor." The corporation had no offices or property within Florida. Nevertheless, this arrangement provided a sufficient nexus to justify the tax. The labelling of the salesman as "independent" was not controlling, it was held, because it would "open the gates to a stampede of tax avoidance" if such a formal contractual designation were allowed to make a constitutional difference. (362 U.S. at p. 211.)

In the present case likewise, the circumstance that investigation and/or settlement services on behalf of plaintiffs in California were performed by independent contractors is of little constitutional significance. The undeniable fact is that they were acting as agents of plaintiffs. Although plaintiffs assert a distinction between the present case and *Scripto* because the salesmen in *Scripto* solicited business for the foreign corporation, whereas here plaintiffs' agents did not perform that function, we are unimpressed by such distinction. What is significant in the present context is that the investigation and settlement of claims is an integral and crucial aspect of the business of insurance. Either or both of these functions were performed with respect to California policyholders by agents of plaintiffs residing in this state.

The utilization by NL of 175 representatives to conduct 153 investigations in California in a 2 year period, and the investigation of 331 claims by IC's agents, who had authority to settle a substantial portion of such claims, cannot be viewed, as plaintiffs urge, as conduct so "sporadic," and "peripheral" to their business that it amounts only to the "slightest presence" by them in California for purposes of taxation. (National Geographic v. Cal. Equalization Bd. (1977) 430 U.S. 551 at p. 556.)

That plaintiffs' agents, whose offices were in California, received the protection of this state's laws can hardly be doubted. In *Scripto,* the "benefit" aspect of the constitutional test was not discussed, apparently on the assumption that a foreign corporation which has agents in the taxing state also receives the protection of that state's laws. And in Standard Steel Co. v. Washington Revenue Department,

supra, 419 U.S. 560, an out-of-state supplier was held to enjoy the protection and benefit of the state's laws because it employed in the taxing state a single employee who worked out of his home, and who "made possible the realization and continuance of valuable contractual relations" between the taxpayer and a Washington corporation. The taxpayer's assertion that its activities in Washington "were so thin and inconsequential" that it derived insufficient benefit to justify the tax "verges on the frivolous," declared the court. (419 U.S. at p. 562.) Similarly, in the present case, the agents employed by plaintiffs performed for them a function crucial to the administration of the insurance policies covering California residents. The benefits afforded to these agents also benefitted plaintiffs.[8]

We hold, therefore, that the character and extent of plaintiffs' activities in this state were sufficient to form the "definite link" and "minimum connection" required to justify imposition of the tax, and that plaintiffs received the benefit of this state's laws through the protections afforded to their agents in California.

Our conclusion is supported by decisions from other jurisdictions. In three cases, the power of a state to tax mail order insurers was upheld even though the activities of the

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[8]The board argues that, as the trial court held, plaintiffs received the benefit of California's health, police and court systems, since these protections and services had the effect of diminishing the claims made against plaintiffs on the policies sold to Californians. Plaintiffs counter that these benefits did not accrue to them because they took such services into account in setting insurance rates. Therefore, they assert, it is the California insureds rather than plaintiffs who gained from the benefits and services provided by the state. We need not resolve this debate in view of the conclusion we reach.

insurers in the taxing state were similar to or less extensive than those of plaintiffs. In Ministers Life and Casualty Union v. Haase (Wis. 1966) 141 N.W.2d 287, the insurer employed methods of solicitation similar to those in the present case for insurance contracts with individuals. Unpaid "group leaders" negotiated insurance contracts for some group policies, enrolled members, received the policies and premium notices, and collected and remitted premiums. There was no indication that local agents performed claims investigations. National Liberty Life Insurance Company v. State (Wis. 1974) 215 N.W.2d 26 upheld a tax on a foreign mail order insurer largely on the basis of the substantial volume of business enjoyed by the insurer in the state.

Armed Forces Co-op etc. v. Department of Insurance (Wyo. 1980) 622 P.2d 1318, involved a foreign insurer which was an unincorporated, nonprofit military association, all of whose members were active or retired military personnel. The insurer urged its members in Wyoming to solicit others to buy insurance. It had no paid representatives, salesmen, offices or property in Wyoming and had only 99 policies in force in that state. Most claims were paid without investigation but, if the insured chose, he could seek to have the claim evaluated by a professional claims adjuster or a volunteer advisory board consisting of three unpaid persons, or he could obtain a statement from a local official or disinterested witness concerning the circumstances of the loss.

While the foregoing cases related to the power of the state to both regulate and tax a foreign insurer, we do not deem this circumstance significant. It should also be noted that the United States Supreme Court dismissed appeals

for want of a substantial federal question in *Ministers* (385 U.S. 205) and *Armed Forces Co-op* (454 U.S. 1130). Such dismissals constitute a determination on the merits. (Washington v. Yakima Indian Nation (1979) 439 U.S. 463, 476-477, fn. 20; Hicks v. Miranda (1975) 422 U.S. 332, 344-345; Eaton v. Price (1959) 360 U.S. 246, 247.)

The parties cite numerous other cases in addition to those discussed above in support of their positions, but the facts are so clearly distinguishable from the present circumstances that it would serve no useful purpose to discuss them in detail. (E.g., *Authority to tax foreign corporation denied:* Norton Co. v. Dept. of Revenue (1951) 340 U.S. 534 [direct orders mailed to and shipped from foreign corporation out of state]; Miller Bros. Co. v. Maryland (1954) 347 U.S. 340 [purchases made in foreign state; advertising and delivery of goods by common carrier and occasionally by retailer's own trucks in taxing state]; St. Louis Cotton Compress Co. v. Arkansas (1922) 260 U.S. 346 [no act by foreign insurer in taxing state but insured property located there]; *Authority to tax foreign corporation affirmed:* Felt & Tarrant Co. v. Gallagher (1939) 306 U.S. 62 [payment for goods mailed to retailer outside state, but retailer had sales agents in state]; General Trading Co. v. Tax Comm'n. (1944) 322 U.S. 335 [traveling salesmen from state of foreign corporation's domicile traveled to taxing state to solicit sales].)

Our conclusion that the contacts between plaintiffs and California are sufficient to justfy imposition of the tax are also important to the resolution of two additional contentions made by plaintiffs.

First, they argue, they were not "doing business" in California within the meaning of article XIII, section 28, subdivision (b), of the California Constitution which, as we have seen, provides for a tax on insurers "doing business" in this state. They rely on three cases for the proposition that the state in which administrative functions in connection with insurance policies are performed is of "great significance" in evaluating whether a foreign corporation is "doing business" in California. (Occidental L. Ins. Co. v. State Bd. of Equal. (1956) 139 Cal.App.2d 468; People v. Alliance Life Ins. Co. (1944) 65 Cal.App.2d 808; Western T. Acc. Assn. v. Johnson (1936) 14 Cal.App.2d 306.) Of these cases, only *Alliance* invalidated a tax based on insurance premiums. That case, unlike the present one, did not involve the employment by the insurer of agents within California to perform important functions in connection with the administration of the policies it had issued to this state's residents.[7] These activities are sufficient to justify the conclusion that plaintiffs' were "doing business" in this state within the meaning of the Constitution.

Next, plaintiffs urge, the tax is invalid as a violation of due process and equal protection because it is measured by the total premiums collected from California policyholders, and therefore reaches "profits which are in no just

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[7]In *Alliance*, the insurer had ceased soliciting business in California and did not renew its certificate of authority to conduct business in this state, nor did it write any new policies. It did, however, continue to collect renewal premiums from California residents on policies effective before it surrendered its license. These premiums were mailed to Illinois. The state's attempt to tax these renewal premiums was held invalid on the ground that the insurer was no longer "doing business" in California.

sense attributable to transactions" within this state. (See Hans Rees' Sons v. No. Carolina (1931) 283 U.S. 123, 134-135.) Plaintiffs contend the premiums they received from California policyholders were generated largely by activities carried out in their home states, and California's imposition of the tax on the whole of the premiums collected is "out of all appropriate proportion to the business transacted" in California.

A number of cases have held that a tax based on the total sales made within a state is not invalid even though some activities (including major functions such as the manufacture of the product) occurred in other jurisdictions. Standard Steel Co. v. Washington Revenue Department, supra, 419 U.S. 560, upheld a Washington tax based on the total sales of a manufacturer in the taxing state even though its home office and manufacturing plants were located outside the state. Aside from periodic visits by the taxpayer's engineers to its principal customer in Washington, the corporation's total activity in Washington consisted of the employment of a single employee who worked out of his home and consulted with the customer regarding its needs, and followed up if any difficulties arose after delivery of the product. It was held that the tax was "apportioned exactly to the activities taxed," i.e., the sales which resulted from the activities of the taxpayer's employee in Washington, who "made possible the realization and continuance of valuable contractual relations" between the taxpayer and the corporation. (419 U.S. at pp. 562, 564.) A similar result obtained in General Motors v. Washington (1964) 377 U.S. 436, 448, in which a tax on the wholesale price of automobiles and parts manufactured outside Washington was

upheld on the ground that the taxpayer had mingled its taxable business with that which it claimed to be nontaxable through "a maze of local connections."

In Moorman Mfg. Co. v. Bair, supra, 437 U.S. 267, an Iowa tax on the gross sales of products manufactured by a foreign corporation in another state was held to be valid even though the court recognized that the profit from the sales was generated in part by the corporation's activities in the foreign state. The opinion comments that the states have a "wide latitude in the selection of apportionment formulas," and an assessment will only be disturbed if "the taxpayer has proved by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State,' . . . or has 'led to a grossly distorted result.'" (437 U.S. at p. 274.)[8]

Finally, in Equitable Life Society v. Pennsylvania (1915) 238 U.S. 143, Pennsylvania imposed a tax on the gross premiums written on policies which covered residents of that state, even though some of the premiums were paid outside the state by Pennsylvania residents. In upholding Pennsylvania's right to tax such premiums, the court noted that a certain latitude must be allowed in measuring the tax, that many incidents of the contract occurred in Pennsylvania (such as payment of dividends when received in

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[8]The tax in *Moorman* was not based on gross sales made in Iowa, but it was unapportioned in the sense that it was measured by the proportion which the sales made within the state bore to the gross sales of the taxpayer. Since the formula did not take into consideration the fact that some of the amounts realized from the Iowa sales may have been attributable to the state in which the goods were manufactured, the tax was "unapportioned" in the respect we discuss here.

cash, sending an adjuster into the state in case of dispute, or making proof of death), and that it was "not unnatural" to take the policyholders residing in Pennsylvania as a measure of the tax because taxation "has to be determined by general principles." (238 U.S. at p. 147.)

While these cases are distinguishable on their facts, they state principles which are applicable to the tax under consideration here: an unapportioned tax measured by the total sales of a foreign corporation within a state may be valid even though major functions which contributed to the value of the taxed product, such as its manufacture, occur outside the taxing state; the importance of the foreign corporation's activity in the taxing state to the "realization and continuance" of the corporation's business therein is a significant factor in evaluating the contacts between the state and the corporation; and the taxpayer challenging the failure to make an apportionment has the burden of showing by "clear and cogent" evidence that the tax is out of all proportion to the business transacted in the state and leads to "grossly disproportionate results."

Plaintiffs have not made such a showing here. Their agents in California conducted on their behalf a substantial number of investigations of claims made by California policyholders. Although the number of these investigations was not overwhelming in comparison with the over-all number of claims filed by this state's residents—most claims could be processed without local investigation—whenever such investigations were required because telephone or mail inquiries were inadequate to resolve plaintiffs' questions regarding the claims, they were conducted

by plaintiffs' agents in California. Indeed, IC's agents had the power to conclude settlements on its behalf. Moreover, as we have observed, the investigation of claims is an important and integral part of the business of insurance; the conduct of plaintiffs' agents was critical to the "realization and continuance" of the business conducted by plaintiffs in this state. We conclude, therefore, that plaintiffs did not show by "clear and cogent" evidence that the unapportioned tax on the premiums of California policyholders is out of all proportion to the conduct of their business in this state, so as to lead to "grossly disproportionate results."[9]

Plaintiffs' final argument is that the state should be estopped to impose the tax retroactively. They claim that they justifiably relied on the general understanding in the legal community and the insurance industry prior to 1968—when the state first sought to impose the tax in issue—that mail order insurers were not subject to a tax on premiums,[10] and that affirmative representations to that effect were made to them by a California official. They urge that it would be unjust to allow the state to levy a tax upon them retroactively in view of such reliance, particularly

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[9]National Liberty Life Insurance Co. v. State, supra, 215 N.W.2d 26, concluded that a tax on gross premiums of a mail order insurer was invalid because it was unapportioned. The board challenges this conclusion on its merits, but we need not discuss the reasoning of the decision in detail since in that case, unlike the situation here, there was no evidence of claims settlement activity in Wisconsin by the foreign insurer.

[10]Plaintiffs rely, for example, on a report of the National Association of Insurance Commissioners in 1968 that direct mail insurers "have ample reason to suppose" that they are not subject to taxation. (See also Hanson & Obenburger *Mail Order Insurers* (1966) 50 Marq.L.Rev. 175.)

because they are unable to recoup the tax from the insureds.

United States Fidelity & Guaranty Company v. State Board of Equalization (1956) 47 Cal.2d 384, sets forth the general rules applicable to estoppel of the government in tax matters. Estoppel is available only in the "unusual case" in which its justification is "clear and the injustice great." The failure to collect the tax authorized by a statute is insufficient to justify estoppel, even if the taxpayer relies on an erroneous construction of a statute by an official. (*Id.* at pp. 389-390.) Nevertheless, the opinion proceeds to discuss whether certain conduct of the Insurance Commissioner constituted a "clear representation" that a portion of the insurer's premiums in that case would not be taxed. It concludes that the commissioner's conduct was not such "as would satisfy an estoppel in connection with taxes." (*Id.* at p. 392.) We need not decide whether even a "clear representation" by a public official that a tax is not payable can immunize a taxpayer from the duty to pay a tax authorized by law, because we determine that such representation was not made in the present case.

The "clear representation" relied on by plaintiffs is contained in a letter written in 1961 by an official in the compliance and legal division of the department stating, "[t]he laws of this State do not, and it is our understanding that they could not constitutionally regulate the transaction of insurance through the United States mail."

The letter was written to an individual in NL's home state who acted as a consultant to the president of NL, and there is no indication that IC was aware of its content. IC's reliance argument, therefore, is based largely

on the state's omission to collect the tax and assumptions made by a national organization and others that the tax would be invalid if it were imposed. Obviously, these matters are insufficient to constitute justifiable reliance.

NL's claim that the 1961 letter provides a basis for such reliance is unconvincing. The letter does not refer to state taxation of mail order insurers, but to their regulation, and NL could not properly have relied on the statements made therein as referring to taxation. The basis of NL's claim to the contrary is its premise that a state which does not have the power to regulate a mail order insurer a fortiori does not have the power to tax it, since a higher level of contacts is required for taxation than for regulation. Thus, it is argued, the statement in the letter referring to regulation also amounted to a representation relating to taxation.

Assuming, without deciding, the validity of NL's premise that a state without power to regulate also cannot tax, there is no indication in the letter that the official who wrote it made the representation upon that assumption. In any event, NL could not have justifiably relied upon any such representation. The letter was written not by an official of the board which is the agency authorized to assess the tax (Rev. & Tax. Code, § 12412), but by an official of the department.[11] NL never sought a ruling or made any inquiry of the board regarding the state's position on taxation of mail order insurers. Moreover, the letter refers only

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[11]We recognize, of course, that the Insurance Commissioner performs some duties with regard to the tax, such as forwarding the tax returns of the insurer to the board (Rev. & Tax. Code, § 12411), auditing the return (§ 12421), and proposing deficiency assessments to the board when appropriate (§12422).

to an "understanding" of state law with respect to regulation, and cannot reasonably be interpreted as a definitive ruling on the question of taxation. Under all the circumstances, we hold that NL failed to establish that it justifiably relied on a statement by a public official that the premiums received from California residents were not subject to taxation.[12] It is hardly necessary to observe that this is not the "unusual case" in which justification for the estoppel is "clear and the injustice great."

The authorities cited by plaintiffs in support of their claim of estoppel are not persuasive. For the most part they involved attempts to retroactively impose a tax following amendment of a statute (Equitable Life Assur. Soc. v. Thulemeyer (Wyo. 1935) 52 P.2d 1223, 1234) or a change in an official administrative ruling (Garrison v. State of California (1944) 64 Cal.App.2d 820, 828-830), a clearly distinguishable situation from the present case.[13]

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[12]In *United National*, supra, 66 Cal.2d 577, 596-597, the same letter was held insufficient to constitute a binding administrative construction of a statute which was there interpreted to allow regulation of mail order insurers, and the failure of the state to attempt such regulation under the statute for many years was held insufficient to justify estoppel of the state to initiate regulation.

[13]Pacific Southwest Airlines v. State Board of Equalization (1977) 73 Cal.App.3d 32, is not contrary to our conclusion. That case concerned a ruling by the board which added a qualification for exemption from the sales tax. The ruling was held invalid as an administrative regulation because the board had failed to follow the statutory procedures for adoption of such a regulation which would have afforded the taxpayer notice thereof. The facts and issues involved in that case are obviously different than those we consider here. Estoppel was not in issue and the board's interpretation of the requirements for an exemption was held to be invalid. We do not read the language of the opinion, as plaintiffs urge, to require that

The judgment is affirmed.

Mosk, J.

WE CONCUR:

Bird, C.J.

Richardson, J.

Kaus, J.

Broussard, J.

Reynoso, J.

Grodin, J.

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a taxpayer must receive advance notice of the state's "new understanding" of the meaning of a tax statute to justify imposition of a tax.

Plaintiffs also rely on the recent decision of the United States Supreme Court in Arizona v. Norris (1983) ... U.S. ..., which holds that an employer violated title VII of the Civil Rights Act of 1964 (42 U.S.C. § 2000e et seq.) by offering female employees lower monthly retirement benefits than male employees who made the same contribution to the retirement fund. The majority adopted Jusice Powell's opinion on the issue of retroactivity, which holds that the decision should not be retroactively applied, because of certain policy considerations. This opinion is not convincing authority in the present case. The primary factors justifying nonretroactivity there do not apply here (i.e., a "devastating" financial effect on the State of Arizona and other governmental bodies, and the likelihood that employers reasonably relied on a prior decision of the high court which led them to believe that their conduct was legal). Moreover, the case does not involve estoppel or the failure of the government to impose a tax authorized by law. In the tax context, even changes in formal rulings have been applied retroactively. (See, e.g., Dixon v. United States (1965) 381 U.S. 68, 73; Automobile Club v. Commissioner (1957) 353 U.S. 180, 183-186; Benedict Oil Co. v. United States (10th Cir. 1978) 582 F.2d 544, 549; see also Diedrich v. Commissioner (1982) 457 U.S. 191, 200, fn. 10.)

Illinois Commercial Men's Association v.
State Board of Equalization
National Liberty Life Insurance Company v.
State Board of Equalization
S.F. 24557

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Trial Court & No.:	San Francisco Superior Court No. 608-989; 650-415; 650-322
Trial Judge:	The Hon. Edward L. Cragen

Appendix B

In the Court of Appeal of the State of California

First Appellate District, Division Three

A013319
1 Civ. No. 53866

A013320
1 Civ. No. 53867

Illinois Commercial Men's Association,
Plaintiff and Appellant,

v.

State Board of Equalization,
Defendant and Respondent.

National Liberty Life Insurance Company,
Plaintiff and Appellant,

v.

State Board of Equalization,
Defendant and Respondent.

[Filed March 2, 1983]

Plaintiffs Illinois Commercial Men's Association, a corporation, and National Liberty Life Insurance Company, a corporation, filed separate actions against defendant State Board of Equalization, seeking refunds of taxes allegedly erroneously and illegally assessed and collected. After the actions were consolidated for trial and tried on stipulated facts, judgments were entered for defendant. Both plaintiffs

Certified for Publication

have appealed. The primary question in these cases is whether California can constitutionally impose a gross premiums tax on foreign insurance companies which solicit and negotiate insurance transactions with California residents by mail from outside the state, and which occasionally hire independent contractors within the state to facilitate the processing of claims.[1]

The Facts

Both Illinois Commercial Men's Association (hereafter ICMA) and National Liberty Life Insurance Company (hereafter NL) were organized in other states; each has its principal place of business in the state of its incorporation.[2] During the years in question, both companies marketed accident, health, and life insurance policies in California by advertising in national publications and by direct mail solicitation of prospective customers; NL advertised in local publications as well.[3]

Persons interested in insurance submitted applications by mail to the company's home office. If the application was accepted, a contract of insurance was formed in the company's home state, and a policy was mailed to the applicant. NL also utilized some solicitations containing a policy which a California resident could accept by mailing a

[1]Because this issue is common to both cases, and because the facts in each case are similar, we dispose of the two appeals in this single decision. (See *Seibert v. Sears, Roebuck & Co.* (1975) 45 Cal.App.3d 1, 4.)

[2]ICMA was incorporated in Illinois, NL in Pennsylvania.

[3]The insurance sold by NL to California residents was actually marketed by DeMoss Associates, Inc. (hereafter DeMoss), a Pennsylvania corporation. Pursuant to an agreement between the two, NL was to pay all premium taxes on policies which it underwrote.

"validating certificate" to the company. Payment of subsequent premiums was by mail. In most instances, ICMA applications were processed without investigation, although on an average of five or six times a year, ICMA would request independent contractors within the state to confirm application information. Applications for policies underwritten by NL were generally processed without investigation.

Between 1963 and 1968, ICMA issued over 105,000 policies in California. Between 1963 and 1967, approximately 3,318 claims were filed by its California policyholders. When an insured made a claim, ICMA would send a form to be completed by the claimant and his physician; most claims were processed upon return of those forms. Approximately 10 percent of claims would not be processed until ICMA received confirming information from the independent contractors in California, who collected data from physicians, hospital personnel, police, and in some instances from the claimant, his family, or his representatives. After receiving this added information, ICMA would usually process and pay the claim. In a few difficult cases, where the above procedure did not result in claim resolution, another independent contractor in California was requested to obtain confirming information; that contractor had authority to settle on behalf of ICMA. Between 1965 and 1968, 124 California claims were handled in this manner. Between 1963 and 1967, two claims resulted in lawsuits in California, both of which were settled.

Between 1963 and 1965, the estimated total number of NL's life insurance policyholders was 885, and its accident and health policyholders, 38,167. During those years, 7,745

claims were filed by California residents. During the processing of claims, NL occasionally asked Retail Credit Company (hereafter Retail), an independent organization, to collect necessary data by interviewing doctors, hospital personnel, police, and other persons, and by obtaining copies of documents such as physicians' and police officers' reports. During 1963-1965, NL utilized Retail in processing about two percent of its claims. Retail used 175 representatives to conduct approximately 153 investigations in California on behalf of NL, for which the insurance company paid fees of approximately $3,785. Retail was not authorized to offer or make settlements on NL's behalf.

Neither ICMA, NL, nor DeMoss owned or leased any property in California. Neither employed agents, representatives, quasi-agents, "missionary men," nor group organizers to solicit business in the state. The only persons who acted in California on the companies' behalf were the independent contractors whose activities have been detailed above.

Sometime in 1965, the state publicly took the position that unlicensed foreign mail-order insurers were subject to regulation by the state. In August 1968, NL did become licensed and certificated by the state's Department of Insurance. ICMA is not now and never has been licensed by nor had a certificate of authority from the Department of Insurance, and has ceased soliciting insurance business in this state.

In May 1968, the department notified plaintiffs of its intention to assert liability for gross premium taxes for the years 1963 through 1967 pursuant to article XIII, sec-

tion 14-4/5 of the California Constitution (renumbered § 28 in 1974), and Revenue and Taxation Code section 12201.[4] At no time prior had the state assessed or attempted to assess a tax upon the premiums received by plaintiffs from their direct mail insurance sold to California residents. The State Board of Equalization assessed premium taxes against NL and ICMA for the years 1963 through 1967. ICMA paid the assessment, which totaled $23,504.54. NL paid gross premium taxes for the years 1963 through 1965 and the interest thereon, totaling $47,747.50. NL and ICMA subsequently filed claims for refund of premium taxes pursuant to Revenue and Taxation Code sections 12978 and 12979, which were denied. These actions followed.

Discussion

Plaintiffs' principal argument is that the taxes which the state has imposed violate the due process clause of the Fourteenth Amendment of the United States Constitution. The due process clause restricts a state's power to tax income generated by the activities of an interstate business by requiring some definite link or minimum connection between those activities and the taxing state. (*Moorman Mfg. Co. v. Bair* (1978) 437 U.S. 267, 273; *Nat. Bellas Hess v. Dept. of Revenue* (1967) 386 U.S. 753, 756.) The controlling question in determining whether a state tax is permissible is whether the state has given anything for which it can

[4]At all times relevant herein, article XIII, section 14-4/5 of the California Constitution provided in pertinent part: "An annual tax is hereby imposed on each insurer doing business in this state . . . ." Revenue and Taxation Code section 12201 provides in part: "Every insurer doing business in this State shall annually pay to the State a tax . . . ."

ask return. (*Ibid.*) In other words, the test is ". . . whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." (*Wisconsin v. J. C. Penney Co.* (1940) 311 U.S. 435, 444.)

In general, the imposition of a tax on a foreign corporation by a state has been upheld against a due process challenge where the corporation has property or solicitors or retail outlets within that state. (See, e.g., *Moorman Mfg. Co. v. Bair, supra,* 437 U.S. 267 [corporation had over 500 salesmen and six warehouses in taxing state]; *Standard Steel Co. v. Wash. Revenue Dept.* (1975) 419 U.S. 560 [corporation had only one employee in taxing state, but he made possible realization and continuation of contractual relations between local consumer and taxpayer corporation]; *Scripto v. Carson* (1960) 362 U.S. 207 [corporation had no office, warehouse, or other place of business in taxing state and had no regular employee or agent there, but 10 independent contractors acted as representatives of corporation in the state for purpose of soliciting business].) The Supreme Court has cautioned, however, that it will take more than the "slightest presence" of a foreign corporation to establish the requisite constitutional "nexus" or connection. (*National Geographic v. Cal. Equalization Bd.* (1977) 430 U.S. 551, 556.)

In contrast, in *Nat. Bellas Hess v. Dept. of Revenue, supra,* 386 U.S. 753, the Supreme Court held that Illinois could not impose use tax liability on an out-of-state seller whose only connection with customers in that state was by common carrier or mail. National, a mail-order seller centered in Missouri, had no office, sales outlets, warehouses, salesmen, solicitors, or telephone listings in Illinois, and

did not advertise in Illinois newspapers or on radio or television there. Twice yearly it mailed catalogues to recent customers nationwide, and also mailed advertising to past and potential customers. All customer orders were mailed to Missouri, and goods were sent to customers by mail or common carrier. (*Id.*, at pp. 754-755.)

The court noted that strictly speaking, the person the state sought to tax was the user of goods to whom the company sold, and that there was no question of the connection between the state and that person. But because National was made directly liable for payment of the use tax whether collected from the user or not, the critical question was the connection between that company and the state. (*Nat. Bellas Hess, supra,* at p. 757, fn. 9.) To permit the tax, the court declared, would require the repudiation of "the sharp distinction which [we] have drawn between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business. But this basic distinction . . . is a valid one, and we decline to obliterate it." (*Id.*, at p. 758.) Where the out-of-state seller has solicitors or a retail outlet in the taxing state, that seller has been accorded the protection and services of the taxing state. Where the seller's only connection with customers in a state is by common carrier or mail, however, the seller is not receiving benefits from that state for which it can exact a price. (*Ibid.*)

The dissenters in *Nat. Bellas Hess* pointed out that National utilized Illinois' banking and credit facilities to carry on its business in that state, as a substantial part of its

sales were on credit. In addition, the dissenters thought it reasonable to assume that the company utilized local representatives to collect any delinquent accounts. (*Nat. Bellas Hess, supra,* 386 U.S. at p. 762 [dis. opn. of Fortas, J.].) As the majority ignored those local connections, however, we can only conclude that it considered them either too indirect or too insubstantial to satisfy its constitutional standard of nexus.

Plaintiffs rely on *Nat. Bellas Hess* to argue that because neither company had property nor agents soliciting business within California, the links between them and the state are constitutionally insufficient to allow the imposition of the taxes at issue. In reply, the state argues that the California Supreme Court in *People v. United National Life Ins. Co.* (1967) 66 Cal.2d 577, appeal dismissed 389 U.S. 330, has already determined that the state has power to tax mail order insurers. The state argues that *Nat. Bellas Hess* is not controlling because the insurance business is different from the mail-order retail sales business, and because plaintiffs' contacts with this state were significantly greater than those of National with Illinois.

The question in *People v. United National Life Ins. Co., supra,* 66 Cal.2d 577, was whether California could, in accordance with principles of due process, regulate foreign mail-order insurers who had no agents in the state and who solicited and negotiated insurance transactions with California residents exclusively by mail from offices outside the state. In resolving that question, the court traced the development of state regulation and taxation of the insurance business, and noted that with the passage of

the McCarran Act (15 U.S.C.A. §§ 1011-1015) in 1945, Congress removed all commerce clause limitations on the authority of the states to regulate and tax the insurance business. (*Id.*, at p. 585; see *Western & Southern L. I. Co. v. Bd. of Equalization* (1981) 451 U.S. 648, 653.) The court then analyzed federal due process clause limitations on a state's power both to regulate and to tax insurance companies, and concluded that interstate insurance transactions can properly be regulated when they have sufficient contacts with the regulating state so as to give the latter a "substantial interest" in the transactions. The court flatly rejected the argument that the power to regulate turned on the presence of agents in the regulating state.

The court then held that in the cases before it, there were sufficient contacts with California to justify regulation. "The insureds are, of course, residents of California. The solicitation of insurance actually takes place in California where the advertising material and other forms are received by the individual addressees. Thus realistically viewed the insurer through the instrumentality of the mail is for all practical purposes soliciting insurance here as manifestly as if it were to carry on such solicitation through representatives physically present within this state. [Citations.] In response to this solicitation, California residents complete and sign in this state the applications for insurance. Indeed, defendant United sends to the California addressee a pre-indorsed policy which becomes effective *in this state*, when the policyholder deposits in the mail here the completed 'ownership application' for return to United's home office. In all instances payment of premiums is made by California residents from funds or bank ac-

counts located in California. It is clear that any claims made under the policies will most likely be investigated in this state and that any litigation in connection with the policies will undoubtedly be commenced in California courts. It is also forseeable [*sic*] that should defendants for any reason fail to perform their obligations in accordance with the policies, California might be called upon to provide assistance for the persons within its borders who were intended to be financially assisted by the benefits under the policies." (*People v. United National Life Ins. Co., supra*, 66 Cal.2d at p. 593, fns. omitted.)

In *Conn. General Co. v. Johnson* (1938) 303 U.S. 77, California sought to impose a tax on premiums received by a Connecticut insurer in that state for policies which it issued to other insurance companies, reinsuring them against loss on life insurance policies which they issued to California residents. The state attempted to justify the tax as imposing no burden on the insurer in light of deductions which it was allowed on its other business within the state. The court rejected that argument, stating, "[b]ut the limits of the state's legislative jurisdiction to tax, prescribed by the Fourteenth Amendment, are to be ascertained by reference to the incidence of the tax upon its objects rather than the ultimate thrust of the economic benefits and burdens of transactions within the state. As a matter of convenience and certainty, and to secure a practically just operation of the constitutional prohibition, *we look to the state power to control the objects of the tax as marking the boundaries of the power to lay it. Hence it is that a state which controls the property and activities within its boundaries of a foreign corporation*

admitted to do business there may tax them. But the due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere. [Citations.] It follows that such a tax, otherwise unconstitutional, is not converted into a valid exaction merely because the corporation enjoys outside the state economic benefits from transactions within it, which the state might but does not tax, or because the state might tax the transactions which the corporation carries on outside the state if it were induced to carry them on within." (*Id.*, at pp. 80-81, emphasis added.)

Relying heavily upon the underscored language, the state contends that at least with respect to insurance companies, its power to tax is coextensive with its power to regulate. Therefore, the state reasons, the issue in these cases was necessarily decided in its favor years ago when the California Supreme Court rendered its decision in *United National Life Ins. Co., supra*, 66 Cal.2d 577 (hereafter *United National*). We disagree. We read the *Conn. General* court's reference to a state's regulatory power as marking the outer limits of its power to tax: a state only has constitutional power to tax a foreign corporation which it also has power to regulate. It does not necessarily follow, however, that the presence of the power to regulate is always accompanied by the power to tax. The taxability of mail order insurers such as plaintiffs was not at issue in *Conn. General*, and it is axiomatic that a case is not authority for a proposition not considered therein. (*Ginns v. Savage* (1964) 61 Cal.2d 520, 524, fn. 2.) Furthermore, the critical question in deciding whether a state has jurisdiction to tax is whether the state has given anything for

which it can ask return. (*Nat. Bellas Hess, supra*, 386 U.S. at p. 756; *Wisconsin v. J. C. Penney Co., supra*, 311 U.S. at p. 444.) That question was neither answered nor even asked in *United National*. While we recognize that the court in *United National* relied on cases involving taxation as well as regulation in reaching its conclusion, "[q]uestions which merely lurk in the record, neither brought to the attention of the court nor ruled upon, are not to be considered as having been so decided as to constitute precedents.' [Citation.]" (*Canales v. City of Alviso* (1970) 3 Cal.3d 118, 127-128, fn. 2.)

We must decide, then, whether plaintiffs' contacts with California are such that the state has provided protection, opportunities, and benefits to these companies for which it can fairly ask return. (See *Wisconsin v. J. C. Penney Co., supra*, 311 U.S. at p. 444.)

Neither plaintiff had any employees, agents, representatives, nor quasi-agents soliciting business in California. Nor did either have any interest in real property here. Nevertheless, we recognize that unlike the mail-order seller in *Nat. Bellas Hess*, plaintiffs were not sellers whose *only* connections with their California customers were by mail. The insurance business is markedly different from the retail sales business, as the sale of an insurance policy commences a continuing relationship between the insured and the insurer which is likely to result in the filing of a claim; investigation and negotiation may follow prior to payment or settlement. While these plaintiffs handled the processing of insureds' claims almost exclusively by mail, each, in a small percentage of cases, used independent contractors in the state to investigate claims. Moreover, ICMA on a few

occasions authorized such independent contractors to settle claims on its behalf. We recognize that labeling individuals as "independent contractors" is of no constitutional significance if they in fact function as salesmen in a state soliciting and securing a substantial flow of business for a foreign company. (See *Scripto v. Carson, supra,* 362 U.S. at p. 211.) In these cases, however, the independent contractors had absolutely no part in the solicitation of insurance for either company, and their activities were of relatively little overall significance in the conduct of either company's business. Ninety percent of ICMA's claims during the four years at issue were processed without any activity in this state by claims investigators. Between 1963 and 1965, about 98 percent of NL's claims were processed without investigator assistance in this state. We view the occasional activities in this state of independent contractors on behalf of these companies as akin to those which the Supreme Court by implication found constitutionally insignificant in *Nat. Bellas Hess,* and conclude that they were insufficient to establish the minimum link necessary to make the state's tax permissible.

We also reject the state's argument that the tax is justified because plaintiffs were benefitted by the protections which the state affords to its residents, many of whom are plaintiffs' insureds. In effect, the state argues that the mere presence of insured persons or property within a state is sufficient to justify the imposition of taxes on an insurance company by that state; however, the law is otherwise. (See *Conn. General Co. v. Johnson, supra,* 303 U.S. 77; see also *State Bd. of Ins. v. Todd Shipyards* (1962) 370 U.S. 451;

but see *National Liberty Life Ins. Co. v. State* (Wis. 1974) 215 N.W.2d 26, 34.)

In sum, we conclude that neither plaintiff in these cases had the minimum connection with California necessary to justify the state's imposition of a gross premiums tax. Accordingly, we need not consider plaintiffs' remaining contentions.

Judgments are reversed, and the trial court is directed to enter judgments in favor of plaintiffs and against defendant.

CERTIFIED FOR PUBLICATION

Scott, J.

We concur:

White, P.J.

Barry-Deal, J.

A013319, 1 Civ. 53866, Illinois Commercial Men's Association v. State Board of Equalization

A013320, 1 Civ. 53867, National Liberty Life Insurance Company v. State Board of Equalization

Trial Court:

Superior Court, City and County of San Francisco

Trial Judge:

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A013319, 1 Civ. 53866, Illinois Commercial Men's Association v. State Board of Equalization

A013320, 1 Civ. 53867, National Liberty Life Insurance Company v. State Board of Equalization

Appendix C

California Superior Court
City and County of San Francisco

Department Number Three

Nos. 608989, 650415
No. 650322

Illinois Commercial Men's Association, a corporation,
Plaintiff,

vs.

The State of California, and the
State Board of Equalization thereof,
Defendants.

National Liberty Life Insurance Company, a corporation,
Plaintiff,

vs.

The State Board of Equalization,
Defendant.

[Filed August 21, 1979]

MEMORANDUM OF OPINION

Background:

The parties have submitted a 'Stipulation as to Facts.' Plaintiffs, Illinois Commercial Men's Association (ICMA) and National Liberty Life Insurance Company (National Liberty), are insurers incorporated in Illinois and Pennsylvania respectively. During the years 1963-1967, plaintiffs operated mail-order insurance business with California residents, as well as with residents of other states.

Under a certificate issued by the California Insurance Commissioner, National Liberty continues to sell mail order insurance here. ICMA ceased selling insurance in the state after 1967.

During the four years in question (1963 through 1967) plaintiffs marketed their insurance in California primarily through ads in newspapers, magazines, some on radio, and direct mail solicitation to California residents. The majority of the insurance contracts were formed upon acceptance by the company of an application completed by the California domiciliary and mailed to the company in the latter's home state. Others were actually formed in California, using a somewhat different acceptance format.

Neither plaintiff had any actual employees, agents, or representatives in California, nor did either have interests in any real or personal property here. Both plaintiffs did hire "independent contractors" who engaged in business in California on their behalf, such as claims investigators, examining doctors and attorneys (for processing litigated claims.)

Issues Presented:

The primary issue is whether plaintiffs' activities constituted "doing business" in this state sufficiently to bring them within the constitutional and statutory provisions which would allow California to levy a premiums tax on insurers for the privilege of doing business within the state. If plaintiffs are found to be taxable, then the court must determine whether the tax as it is now imposed is fairly apportioned to the activities within this state, and also

whether the state may impose the tax retroactively for the period in question, 1963-1967, as defendant did not notify plaintiffs of the tax imposition until 1968.

Constitution and Statutes Applicable:

1. Article XIII, Section 28, of the California Constitution, states, *inter alia:*

> "(a) 'Insurer,' as used in this section, includes insurance companies or associations and reciprocal or interinsurance exchanges together with their corporate or other attorneys in facts considered as a single unit and the State Compensation Insurance Fund. As used in this paragraph, 'companies' includes persons, partnerships, joint stock associations, companies, and corporations.
>
> "(b) An annual tax is hereby imposed on each insurer doing business in this state on the base, at the rates, and subject to the deductions from tax hereinafter specified."

II. Revenue and Taxation Code 12201 states, *inter alia:*

> "Every insurer doing business in this state shall annually pay to the State a tax on the bases, at the rates, and subject to the deductions from the tax hereinafter specified."

III. Insurance Code Section 700 states, *inter alia:* "A person shall not transact any class of insurance business in the state without first being admitted for such class. Such admission is secured by procuring a Certificate of Authority from the Commissioner . . ."

California Precedent:

Prior to 1967, California neither regulated nor taxed strictly mail-order insurers. The regulation aspect was

expressly changed by the California Supreme Court in *People v. United National Life Insurance Company*, 66 Cal. 2d 577, 58 Cal.Rptr. 599 (1967), *appeal dismissed*, 389 U.S. 330 (1967). The controversy regarding the taxation aspect which is now before this court arose in 1968 when defendant state, notified the plaintiff companies that it was asserting retroactive liability on plaintiffs for unpaid premium taxes for the years 1963-1967. Defendant based its assessment on *United National*, contending that from that case it may be extrapolated that the state has the power to tax mail-order insurance companies.

United National was a consolidated action brought by the California Insurance Commissioner against three mail-order insurers asserting the State's right to regulate such insurers. It involved some of the same parties and almost identical facts to the case now at bar. The Supreme Court in *United National* carefully reviewed the situation and determined that the mail-order insurers were in fact "doing business" under the applicable statutes, and therefore were subject to regulation by the state. The same basic areas are pertinent to this court's decision as discussed below.

Interstate Commerce:

The McCarran-Ferguson Act (15 U.S.C., Sections 1011-1015) validates the states' power to regulate and tax insurance companies *without* the automatic violation of the Commerce Clause of the United States Constitution (Article I, Section 8) which could otherwise occur. (See also *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 66 S.Ct. 1142, 90 L.Ed. 1342 (1946)). Thus, interstate commerce restrictions are not at issue in the present case.

Fourteenth Amendment:

The Fourteenth Amendment of the U.S. Constitution, however, does present requirements of due process of law which are a separate issue, although the two (i.e., the Commerce clause and Due Process) do often overlap and many decisions have confused them. A series of precedent cases has established that certain minimum contacts are necessary to satisfy the due process of law standards for taxation. Plaintiff herein relies heavily on the fairly recent cases of *National Bellas Hess v. Department of Revenue,* 386 U.S. 753 (1967) and *National Geographic Society v. State Board of Equalization,* 430 U.S. 551 (1977).

National Geographic did deal directly with the question of what constitutes sufficient contacts to establish a taxable nexus, however the court there was dealing with a company which maintained offices in the state, albeit for a different branch of the company than was being taxed. Therefore, the question of *strictly* mail-order business was not addressed directly, and the court only determined that the activity level in the facts before them was enough to sustain the tax.

The court in *National Bellas Hess* refused to sustain a use tax collection duty on a *strictly* mail order firm of retail merchandise. This court finds that a distinction must be drawn between the situation there and the facts now before the court. Retail merchandise sold through mail order catalogues such as was at issue in *National Bellas Hess* is tangible property. Insurance is an intangible and clearly distinguishable on that basis. Imposing a tax, either directly or even as a collection duty, on thousands of different articles sold for varied prices by mail to many

customers is a complex procedure. Taxing insurance premiums paid by mail on only a few types of policies is much simpler and does not impose an undue accounting burden on the insurer whose records would contain the needed information as part of the normal course of business. Therefore, this court finds that the National Bellas Hess decision is not controlling in the case now before it as the types of business involved are significantly different. The sale of an intangible such as insurance is not comparable for purposes of determining tax liability to the sale of taxable retail merchandise articles.

However, the *National Bellas Hess* court did reiterate that the long-standing and determinative due process requirement is "whether the state has given anything for which it can ask return (citations)" (supra at p. 756). A mail order retailer of tangible articles receives little or no direct benefit from the residence states of its customers. A seller of insurance, on the other hand, does receive a benefit from the residence state of its insureds. The insurance business is basically a question of the insurer betting on the health and safety of the people it insures. California clearly then provides many benefits to its citizens which promote their well-being (for example, police and fire protection, highway maintenance and the like). This directly improves the odds on which the plaintiff insurers are gambling with their issuance of insurance policies to those citizens. The state must then be entitled to ask for a return from the insurers who are deriving their income from the safe environment provided by that state to its citizens. Such benefits cannot be provided

without adequate finances. Such financing must, in fairness, come from those benefitting from the services provided by California. The return herein is reasonably demanded in the form of a tax which the defendant has imposed on the plaintiffs.

The 2nd Circuit has recently stated that the police and taxing powers of a state are treated differently for constitutional purposes, and said:

> ". . . extraterritorial impositions of tax collection obligations have been upheld only when it can be said that a benefit has been conferred on the tax collector by virtue of the state's sovereignty, and the tax is related to that benefit (cites omitted)" *Aldens, Inc. v. La Follette,* 552 Fed.2d 745, 749-750 (1977).

This would hold even more true of a direct tax, and defendant state here is providing a taxable benefit.

Plaintiffs maintain, however, that the tax cannot be upheld constitutionally as they do not have sufficient contacts with the state to establish a taxable nexus. They ably argue that there are historically different standards for jurisdiction, regulation and taxation. While not denying the validity of this position, the court finds that plaintiffs' "doing business" within California, as determined by the state's highest court in *People v. United National Life Insurance Company,* 66 Cal.2d 577, 595, 58 Cal.Rptr. 599, *appeal dismissed,* 389 U.S. 330 (1967), is sufficient to sustain taxation as well as regulation. The activity level which the *United National* court considered in reaching its decision

cannot be considered as significant with respect to regulation while de minimus with respect to taxation.* The court therefore finds that there is no violation of plaintiffs' constitutional rights to due process in allowing the defendant state to impose a tax on the business which plaintiffs are doing within California, and that the combined total of plaintiffs' activities is quite sufficient to sustain taxation and not just regulation.

The court's position is reflected in the non-controlling but persuasive 1974 decision of the Wisconsin Supreme Court in *National Liberty Life Ins. Co. v. State,* 62 Wisc. 2d 347, 215 N.W.2d 26 (1974), *cert. denied,* 421 U.S. 946 (1975). The court there referred back to its own prior decision in *Ministers Life & Casualty Union v. Haase,* 30 Wis.2d 339, 141 N.W.2d 287 (1966) that ". . . cases on other types of business are irrelevant to the determination of due process issues in the field of insurance. It then held that apparently in and of itself the large volume of premium dollars collected from Wisconsin citizens by the plaintiff, a Pennsylvania mail order insurance company, established that the company had a taxable nexus in Wisconsin. Here we do not have dollar figures as to the volume of premiums sold by Plaintiffs in California, but the

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*"Thus realistically viewed the insurer through the instrumentality of the mail is for all practical purposes soliciting insurance here as manifestly as if it were to carry on such solicitation through representatives physically present within this state . . .

"In short, these defendants have 'realistically entered the state looking for and obtaining business' (*Ministers Life and Casualty Union v. Haase,* 30 Wis.2d 339 (1966)); the main aspects of their insurance transactions are in this state; and to say that they are not doing business here is to completely ignore the facts of life and reality.' (cites omitted) We think the substantial interest of California in these transactions is obvious." (supra at p. 593)

figures are given that, for example, National Liberty had 8,642 policies in California in 1963, and 20,323 in 1965, and that I.C.M.A. had 13,926 in 1963 and 10,983 in 1967. This is a significant number of people within the state whose well-being benefits plaintiffs, and in combination with the advertising and other contacts (which are admittedly limited), our holding agrees with that of the Wisconsin court, that there is a sufficient nexus to support the state's taxation.

Apportionment:

As this court sustains defendant's right to tax plaintiffs, then plaintiffs' next contention must be considered. Plaintiffs argue that the tax must be apportioned to more specifically relate to that portion of its activities which are in California than the purely gross premiums tax does.

The tax which defendant has imposed is a single factor, gross premiums tax based solely on the dollar amount of the premiums collected from California residents. Again, there is a long history of precedent requiring that taxes be fairly apportioned as to activities within the taxing jurisdiction in order to be "constitutionally proper" (*General Motors Corporation v. Washington,* (1964) 377 U.S. 436, 440; see also *Equitable Life Society v. Pennsylvania* (1915) 238 U.S. 143).

The most recent decision available is *Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 98 S.Ct. 2340 (1978). The Supreme Court there upheld a single factor formula as violative of neither due process nor the commerce clause, stating ". . . (t)hus we have repeatedly held that a single-factor formula

is presumptively valid. . . . (T)he basic principles that the States have wide latitude in the selection of apportionment formulas and . . . a formula produced assessment will only be disturbed when the taxpayer has proved by clear and cogent evidence that the income attributed to the State is in fact out of all appropriate proportion to the business transacted . . . in that state (citations) or has led to a grossly distorted result (cites omitted).

Here again, because the area involved deals with insurance companies, the Commerce Clause is not an applicable concern, based on the McCarran-Ferguson Act, (15 U.S.C., Sections 1011-1015). The primary question then is whether the tax as presently constituted violates plaintiffs' rights to due process under the Fourteenth Amendment. This court holds that the decision reached in the case of *Moorman Mfg. Co. v. Bair* (supra) is controlling here. Although Moorman did involve the sale of tangibles, the court does not consider that in the context of *apportionment*, the distinction between intangible and tangible is critical, where it is with respect to due process violations for *imposing* the tax initially. There is no significant difference in looking strictly at a seller's gross receipts from a state as to whether those monies were generated by a tangible or intangible product. The court is aware that some of the activities producing the insurance "product" here were done outside of California. However, division of the various components which contribute to an insurance policy is not readily done without considerable speculative types of reasoning, none of which the court finds to be conclusive enough to compel a finding in plaintiffs' favor.

Plaintiffs have not shown to the court's satisfaction that this single factor formula produces an "arbitrary result" such as the court required be shown in *Moorman* (supra). The California tax is a straight percentage of the dollar amount of the premiums paid by California residents. California is in no way taxing the money received by plaintiffs, if any, from other states. It is thus apportioned to the premium monies originating in California only. The tax imposed by defendant remains constant only as to California—it is not affected by whether or not, nor by how much, plaintiffs receive premiums from citizens of other states. The plaintiff insurance companies have not raised any issue as to the actual percentage levied being unreasonable, in relation to that levied by any other states. They only argue against the propriety of the tax and the apportionment, or alleged lack thereof.

The court's determination herein that the gross premiums tax is adequately apportioned has support in the decisions of the Supreme Court as to insurance premiums at least as far back as 1915 in *Equitable Life Society v. Pennsylvania*, 238 U.S. 143. The court there held that the tax imposed on the plaintiff life insurance company was on the benefit to the company by the state in keeping its risks alive, and thus a tax on the privilege of doing business within the state. Thus, the tax did *not* have to be apportioned beyond premiums paid.

The Wisconsin court in *National Liberty Life Ins. Co. v. Wisconsin* concluded and held that the gross premiums determination was not a sufficient apportionment after examining a series of cases dealing with this area. However, that

court did not enlighten us with any understandable reasoning in reaching such conclusion.

This court holds that based on the *Moorman Mfg. Co.* decision, a tax calculated from gross premiums received *from this state only* are inherently apportioned, and are not a seizure without due process.

Retroactivity or Prospective Application.

The tax years in the case at bench are 1963-1967 (inclusive). California's *People v. United National Life Insurance Company,* supra, was decided in 1967. After the decision was handed down (and during the years of 1968 to the commencement of this action) ICMA stopped selling insurance in this state. Liberty continued so selling.

California, prior to the *United National* decision, had administratively held that the gross premiums tax did not apply to the type sales activity in which plaintiffs were engaged. Immediately after the finality of the holding in *United National,* the assessments which are the subject of this action were imposed (i.e., for the prior tax years 1963 through 1967, inclusive). The tax collector cannot be blamed for attempting to slake his thirst by going after as much money as he can from deep corporate insurance pocketbooks.

We must be mindful, however, that in an industry which is based upon actuarial statistics in determining the cost of the sale of its products, all costs of production must be taken into account in determining the ultimate price of the product to the purchaser. In the field of insurance, a gross receipts tax based on premiums would be a "cost of production," economically speaking.

The only authority cited in this action to assist this Court in deciding the issue of retroactive application is *Equitable Life Assurance Society v. Thulemeyer*, 52 P.2d 12 (Wyo., 1935). Though the Wyoming case is not directly in point, that court did consider the issue of retroactivity of taxation assessment in not dissimilar conditions as found in the case at bench. At page 1234, it stated:

> "Here . . . the plaintiff [insurance company] would have made its rates for insurance in question higher, if the payment of the taxes now claimed by the state had been required. It has no recourse against anyone. . . ."

For this (and other) reason(s), Wyoming refused to give retroactive application to tax assessments. This Court adopts the reasoning of the Wyoming Court in this regard that the tax cannot be retroactively applied to petitioners.

Conclusion.

The tax, as assessed, is lawful as pronounced under *People v. United States National*, supra, but cannot be applied as against plaintiffs retroactively. It can be assessed by prospective application to plaintiffs for the years 1968 forward.

Defendants shall prepare findings of fact and conclusions of law (if requested), and a judgment in accord with this memorandum of opinion.

Dated: August 20, 1979.

/s/ Edward L. Cragen
Edward L. Cragen
Judge of the Superior Court

California Superior Court
City and County of San Francisco

Department Number Three

Nos. 608989, 650415
No. 650322

Illinois Commercial Men's Association, a corporation,
Plaintiff,

vs.

The State of California, and the
State Board of Equalization thereof,
Defendants.

National Liberty Life Insurance Company, a corporation,
Plaintiff,

vs.

The State Board of Equalization,
Defendant.

[Filed March 26, 1980]

AMENDMENT TO MEMORANDUM OF OPINION

In its intended decision (Memorandum of Opinion, 8/21/79), this Court determined that the respondent Board of Equalization has the power and authority to impose a gross receipts tax on out-of-state mail order insurance companies upon premiums received from policies sold to residents of the State of California (See Memorandum of Opinion, page 13, August 21, 1979).

In its Memorandum of Opinion, the Court further held that the imposition of such tax should be by prospective application and should not be applied retroactively. The basic underpinning of the Court's determination in this regard was (1) fair play, and (2) something akin to, but not reaching the proportions of, due process.

On petition by respondent, the Court agreed to additional briefing and further argument on the propriety of its determination of the proper application of the imposition of the tax to plaintiffs.

Plaintiffs contend in brief and argument that the tax cannot be applied retroactively because the State, by its own action and inaction, is estopped to collect the tax.

The State relies on *Fidelity & Guaranty Co. v. State Board of Equalization* (1956) 47 Cal.2d 384, which holds that an estoppel will not rise against the government in tax matters where the taxpayer relies on an erroneous construction of the statute by a state official. Further, this is especially true if the taxing agency is the State Board of Equalization and the government official upon whom the taxpayer relied was not an official of the Board of Equalization but of another state agency.

There is no question but that equitable estoppel can be applied against a government agency in a proper case. However, the authorities cited by plaintiffs are distinguished in defendant's brief, pp. 12-17. The distinctions are valid in that the cases cited by plaintiffs are not tax cases or the reliance amounted to a gross injustice—more than is shown here. The *Fidelity & Guaranty* Court specifically rejected "but for the wrong statement of the law by the Insurance Commissioner the premiums would have been

greater" as a ground for equitable estoppel against the State. This trial Court cannot overcome the specific holding by the State Supreme Court on the basis of "fair play" and/or "something akin" to due process of law. Such would amount to the Court usurping the powers of the Legislature.

Judicial restraint and *stare decisis* commands that this Court vacate and set aside that part of its holding denying retroactive application and enter a new and different order in compliance with Government Code Section 12432, allowing assessment of taxes to the period within the statute of limitations.

Though the trial Court might very well disagree with the concept of the holding of *U.S. Fidelity & Guaranty* (supra), little (if any) *detrimental* reliance resulted.

That part of the Court's Intended Decision is hereby vacated and set aside so far as it is inconsistent with the holding herein. The remainder of the Court's Intended Decision is incorporated within this Amended Memorandum of Opinion, and (as such) this decision is final.

Defendant to prepare findings of fact and conclusions of law and a judgment in accord with this Amended Memorandum.

Dated: March 25, 1980.

/s/ Edward L. Cragen
Edward L. Cragen
Judge of the Superior Court

Appendix D

Designation of Corporate Relationships

Parents:

National Home Life Assurance Company

Capital Liberty, L.P.

Commonwealth Life Insurance Company

Peoples Life Insurance Company

Capital Holding Corporation

Subsidiaries and Affiliates:

There are no non-100% owned subsidiaries and no affiliates.

Appendix E

[Filed Dec. 14, 1983]

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In the Supreme Court
of the
State of California

S.F. No. 24557

Illinois Commercial Men's Association,
Plaintiff and Appellant,

vs.

State Board of Equalization,
Defendant and Respondent.

National Liberty Life Insurance Company,
Plaintiff and Appellant,

vs.

State Board of Equalization,
Defendant and Respondent.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that National Liberty Life Insurance Company, one of the Plaintiffs and Appellants abovenamed, hereby appeals to the Supreme Court of the United States from the entire final judgment of the Supreme Court of the State of California entered against said Plaintiff/Appellant in this action on October 31, 1983, affirming the judgment of the Superior Court of the State of California, in and for the City and County of San Francisco.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Dated: December 14, 1983

Franklin C. Latcham
Prentiss Willson, Jr.
Anne C. Bloomdahl
Morrison & Foerster

By /s/ Prentiss Willson, Jr.
Prentiss Willson, Jr.
Counsel for Plaintiff
and Appellant

Appendix F

California Constitution, Article XIII, Section 14 4/5, As In Effect November 6, 1962 to November 8, 1966.

(a) "Insurer," as used in this section, includes insurance companies or associations and reciprocal or interinsurance exchanges and the State Compensation Insurance Fund. As used in this paragraph, "companies" includes persons, partnerships, joint stock associations, companies and corporations.

(b) An annual tax is hereby imposed on each insurer doing business in this State on the base, at the rates, and subject to the deductions from the tax hereinafter specified.

(c) In the case of an insurer not transacting title insurance in this State, the "basis of the annual tax" is, in respect to each year, the amount of gross premiums, less return premiums, received in such year by such insurer upon its business done in this State, other than premiums received for reinsurance and for ocean marine insurance.

In the case of an insurer transacting title insurance in this State, the "basis of the annual tax" is, in respect to each year, all income upon business done in this State, except:

(1) Interest and dividends.

(2) Rents from real property.

(3) Profits from the sale or other disposition of investments.

(4) Income from investments.

"Investments" as used in this subdivision (d) includes property acquired by such insurer in the settlement or adjustment of claims against it but excludes investments in title plants and title records. Income derived directly or indirectly from the use of title plants and title records is included in the basis of the annual tax.

In the case of an insurer transacting title insurance in this State which has a trust department and does a trust business under the banking laws of this State, there shall be excluded from the basis of the annual tax imposed by this section, the income of, and from the assets of, such trust department and such trust business, if such income is taxed by this State or included in the measure of any tax imposed by this State.

(d) The rate of the tax to be applied to the basis of the annual tax in respect to each year is 2.35 percent.

(e) Each insurer shall have the right to deduct from the annual tax imposed by this section upon such insurer in respect to a particular year the amount of real estate taxes paid by it, in that year, before, or within 30 days after, becoming delinquent, on real property owned by it at the time of payment, and in which was located, in that year, its home office or principal office in this State. Such real property may consist of one building or of two or more adjacent buildings in which such an office is located, the land on which they stand, and so much of the adjacent land as may be required for the convenient use and occupation thereof.

(f) The tax imposed on insurers by this section is in lieu of all other taxes and licenses, state, county, and municipal, upon such insurers and their property, except:

(1) Taxes upon their real estate.

(2) That an insurer transacting title insurance in this State which has a trust department or does a trust business under the banking laws of this State is subject to taxation with respect to such trust department or trust business to the same extent and in the same manner as trust companies and the trust departments of banks doing business in this State.

(3) When by the laws of any other state or country any taxes, fines, penalties, licenses, fees, deposits of money or securities or other obligations or prohibitions are imposed on insurers of this State doing business in such other state or country, or upon their agents therein, in excess of those imposed upon insurers of such other state or country or upon their agents therein, so long as such laws continue in force, the same obligations and prohibitions of whatsoever kind may be imposed by the Legislature upon insurers of such other state or country doing business in this State, or upon their agents herein.

(4) The tax on ocean marine insurance.

(5) Motor vehicle and other vehicle registration license fees and any other tax or license fee imposed by the State upon vehicles, motor vehicles or the operation thereof.

(g) Every insurer transacting the business of ocean marine insurance in this State shall annually pay to the State a tax measured by that proportion of the underwrit-

ing profit of such insurer from such insurance written in the United States, which the gross premiums of the insurer from such insurance written in this State bear to the gross premiums of the insurer from such insurance written within the United States, at the rate of 5 percentum, which tax shall be in lieu of all other taxes and licenses, state, county and municipal, upon such insurer, except taxes upon real estate, and such other taxes as may be assessed or levied against such insurer on account of any other class of insurance written by it. Deductions from the annual tax pursuant to subdivision (e) cannot be made from the ocean marine tax. The Legislature shall define the terms "ocean marine insurance" and "underwriting profit," and shall provide for the assessment, levy, collection and enforcement of the ocean marine tax.

(h) The taxes provided for by this section shall be assessed by the State Board of Equalization.

(i) The Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, may by law change the rate or rates of taxes herein imposed upon insurers.

(j) This section is not intended to and does not change the law as it has previously existed with respect to the meaning of the words "gross premiums, less return premiums, received" as used in this section or as used in Section 14 or 14¾ of this article.

[On November 3, 1964, paragraph (3) of subsection (f) was amended to read as below:]

(3) When by or pursuant to the laws of any other state or foreign country any taxes, licenses and other

fees, in the aggregate, and any fines, penalties, deposit requirements or other material obligations, prohibitions or restrictions are or would be imposed upon California insurers, or upon the agents or representatives of such insurers, which are in excess of such taxes, licenses and other fees, in the aggregate, or which are in excess of the fines, penalties, deposit requirements or other obligations, prohibitions, or restrictions directly imposed upon similar insurers, or upon the agents or representatives of such insurers, of such other state or country under the statutes of this State; so long as such laws of such other state or country continue in force or are so applied, the same taxes, licenses and other fees, in the aggregate, or fines, penalties or deposit requirements or other material obligations, prohibitions, or restrictions, of whatever kind shall be imposed upon the insurers, or upon the agents or representatives of such insurers, of such other state or country doing business or seeking to do business in California. Any tax, license or other fee or other obligation imposed by any city, county, or other political subdivision or agency of such other state or country on California insurers or their agents or representatives shall be deemed to be imposed by such state or country within the meaning of this paragraph (3) of subdivision (f).

The provisions of this paragraph (3) of subdivision (f) shall not apply as to personal income taxes, nor as to ad valorem taxes on real or personal property nor as to special purpose obligations or assessments heretofore imposed by another state or foreign country in connection

with particular kinds of insurance, other than property insurance; except that deductions, from premium taxes or other taxes otherwise payable, allowed on account of real estate or personal property taxes paid shall be taken into consideration in determining the propriety and extent of retaliatory action under this paragraph (3) of subdivision (f).

For the purposes of this paragraph (3) of subdivision (f) the domicile of an alien insurer, other than insurers formed under the laws of Canada, shall be that state in which is located its principal place of business in the United States.

In the case of an insurer formed under the laws of Canada or a province thereof, its domicile shall be deemed to be that province in which its head office is situated.

The provisions of this paragraph (3) of subdivision (f) shall also be applicable to reciprocals or interinsurance exchanges and fraternal benefit societies.

Appendix G

California Revenue and Taxation Code Section 12201, As In Effect From January 1, 1962 Through December 31, 1981.

Every insurer doing business in this State shall annually pay to the State a tax on the bases, at the rates, and subject to the deductions from the tax hereinafter specified.

No. 83-1251

In The
Supreme Court of the United States
October Term, 1983

NATIONAL LIBERTY LIFE INSURANCE COMPANY
Appellant,

v.

STATE BOARD OF EQUALIZATION,
Appellee.

On Appeal from the Supreme Court of the State of California

MOTION TO DISMISS OR AFFIRM

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QUESTION PRESENTED

Is there a substantial federal due process question regarding California's jurisdiction to tax the California insurance business of a Pennsylvania insurer which conducted its California solicitations by mail and advertising and which had independent contractors present in California as its representatives for claims verification, investigation and litigation?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

No. 83-1251

In The
Supreme Court of the United States
October Term, 1983

NATIONAL LIBERTY LIFE INSURANCE COMPANY
Appellant,

v.

STATE BOARD OF EQUALIZATION,
Appellee.

On Appeal from the Supreme Court of the State of California

MOTION TO DISMISS OR AFFIRM

Appellee, pursuant to Rule 16 of the Rules of the Supreme Court of the United States, hereby moves this Court to dismiss this appeal or to affirm the decision of the California Supreme Court on the ground that this case does not present a substantial federal question.

INTRODUCTORY STATEMENT AND SUMMARY OF ARGUMENT

The California Supreme Court has held that the State of California had jurisdiction to apply its insurance tax upon appellant National Liberty Life Insurance Company for the privilege of conducting its California insurance business.[1] The case was tried on a stipulation of facts (cited herein as "Stip."). The facts are set forth in the opinion of the California Supreme Court and are discussed in some detail in the argument of this motion; in summary, appellant National Liberty was an insurance company, organized and with its home office outside of California, which solicited California life, accident and health insurance business through millions of direct mail solicitations to Californians and considerable magazine, newspaper and radio advertising in California. Stip. ¶¶ 66, 25-29, 61, 63-65. Although appellant had no representatives physically present in California to assist in its solicitation of business, National Liberty had numerous independent contractor representatives (including investigators, doctors, and lawyers) who were physically present in California and who represented National Liberty regarding claims verification, investigation, and litigation (including settlement); during the years at issue approximately 175 investigators conducted approximately 153 claims investigations in California for National Liberty. Stip. ¶¶ 54-58; 67.

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1 The California decision is reported as *Illinois Com. Men's Assn. v. State Bd. of Equalization* (1983) 34 Cal.3d 839, 671 P.2d 349, 196 Cal.Rptr. 198; citations to that decision herein will be to the official reports and to appendix A of appellant's jurisdictional statement (J.S. App. A). Illinois Commercial Men's Association has filed a separate jurisdictional statement with this Court (No. 83-1264).

Appellant challenges California's jurisdiction to tax on due process grounds. National Liberty's arguments are concentrated on three cases: *National Bellas Hess v. Dept. of Revenue* (1967) 386 U.S. 753; *Scripto v. Carson* (1960) 362 U.S. 207; and *Miller Bros. Co. v. Maryland* (1954) 347 U.S. 340.

The three cases primarily discussed by appellant can be succinctly covered. While the *National Bellas Hess* result rests on the proposition that contacts *only* through the mail or common carrier cannot by themselves provide jurisdictional nexus to tax a general business, here the record establishes that National Liberty also had representatives physically present in California, engaging in activities crucial to National Liberty's insurance business. Contrary to appellant's suggestion, the *Scripto* decision clearly stands for the proposition that, for due process jurisdictional purposes, the instate activities of true independent contractors should be treated as activities of the taxpayer; also, there is no indication in *Scripto* that said proposition would be limited only to acts of solicitation. *Miller Bros. Co. v. Maryland* is distinguishable here, as it was distinguished in *Scripto* and *National Geographic v. Cal. Equalization Bd.* (1977) 430 U.S. 551, 561-62, on the basis that the out-of-state seller in *Miller Bros.* had not exploited the taxing state's local market: in *Miller Bros.* all of the taxing state's purchasers were in the seller's home state when they made their purchases.

ARGUMENT

I. The California Supreme Court has properly distinguished National Bellas Hess based on National Liberty's claims investigations in California.

The California Supreme Court, applying the due process jurisdictional standard stated by this Court in *National Bellas Hess v. Department of Revenue* (1967) 386 U.S. 753, 756, has held that California has jurisdiction to tax National Liberty because there is "' "some definite link, some minimum connection" ' " between California and National Liberty and because California has given National Liberty protection for which it can ask return. 34 Cal.3d at 846, 850; J.S. App. A, A-6, A-13.

On page 10 of the jurisdictional statement, appellant National Liberty follows an accurate quotation from this Court's *National Bellas Hess* decision with a quite inaccurate representation of what that decision "stands for". Unlike the current case, *National Bellas Hess* involved both the due process clause and the commerce clause, for it involved the catalog sale of general merchandise rather than the business of insurance.[2] This Court's holding in *National Bellas Hess* was made on the basis that "[*a*]*ll* of the contacts which National does have with the State

2 Insurance tax cases (such as the one at bar) do not involve the commerce clause: the McCarran-Ferguson Act (15 U.S.C.A. §§ 1011-1015) has removed all commerce clause restrictions from the state regulation and taxation of insurance business. *Western & Southern L.I. Co. v. Bd. of Equalization* (1981) 451 U.S. 648, 6[illegible]3.

are via the United States mail or common carrier." 386 U.S. at 754 (emphasis added).[3]

The California Supreme Court has distinguished *National Bellas Hess* from the current case on the clear basis that National Liberty had many representatives actually in California acting on its behalf in numerous claims investigations during the years at issue. 34 Cal.3d at 849-52, J.S. App. A, A-12 - A-15. (The status of these representatives as independent contractors is discussed below.) The California Supreme Court recognized these claims activities as being a "function crucial to the administration of the insurance policies covering California residents" and held as follows:

> "We hold, therefore, that the character and extent of plaintiffs' activities in this state were sufficient to form the 'definite link' and 'minimum connection' required to justify imposition of the tax, and that plaintiffs received the benefit of this state's law

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3 In note 14 on page 18 of its jurisdictional statement, National Liberty attempts to use factual assumptions made by the *dissent* in *National Bellas Hess* to soften the clear and restricted basis of the majority opinion. See also J.S. 14 n. 11. The *National Bellas Hess* record contained no evidence of *any* contacts with the taxing state other than via the United States mail or common carrier; the entire point of that litigation was to determine the validity of an Illinois statute which framed tax collection jurisdiction solely upon soliciting orders "'by means of catalogues or other advertising . . . .'" See *id.* at 755. The majority decision was made on the basis that National Bellas Hess' "only connection with customers in the State is by common carrier or the United States mail." *Id.* at 758. As far as follow-up activities are concerned, the *National Bellas Hess* majority opinion recognizes that under the facts presented to this Court, National Bellas Hess did not have in Illinois any "' type of representative . . . to service merchandise it sells . . . .'" *Id.* at 754.

through the protections afforded their agents in California." *Id.* at 850; J.S. App. A, A-13 (footnote omitted.)[4]

It is respectfully submitted that the California Supreme Court has properly distinguished this Court's *National Bellas Hess* decision in reaching this holding.

Appellant National Liberty mistakenly relies upon *National Bellas Hess* in claiming that a nondomiciliary corporation which has no property or office in the taxing state *must* employ *solicitors* to generate business within the state in order to be subject to that state's taxing jurisdiction. J.S. 10. No such "in person" solicitation requirement is stated or implied in the *National Bellas Hess* majority opinion, and appellant later recognizes (J.S. 18 n. 14) that "counsel is unaware of any explicit statement by this Court to the effect that follow-up activities within a state are less important than solicitation in conferring state tax jurisdiction over a seller . . . ."

The California Supreme Court has considerable support for its determination that National Liberty's representatives' California claims investigation activities

4 National Liberty had additional connections which support California taxing jurisdiction. Since the California Supreme Court decided that the claims representatives in California provided sufficient nexus, that court did not find it necessary to weigh the activities conducted by doctors and lawyers paid by National Liberty to act on its behalf in California. Stip. ¶¶ 57, 67. The California Supreme Court noted that under its determination it did not find it necessary to determine also whether health and safety benefits which California provided to National Liberty's insureds also benefited National Liberty. *Id.* n. 6. See *Armed Forces Co-Op., etc. v. Dept. of Ins.* (1980) Wyo., 622 P.2d 1318, 1347, *appeal dismissed* (1982) 454 U.S. 1130.

were "an important and integral part of the business of insurance . . . critical to the 'realization and continuance' of the business conducted by plaintiffs in this state." 34 Cal.3d at 854, J.S. App. A, A-20. It is the privilege of carrying on the insurance business that is being taxed here, not merely the privilege of carrying on insurance solicitations or sales. See *Carpenter v. People's Mut. Life Ins. Co.* (1937) 10 Cal.2d 299, 302, 74 P.2d 508, 510.[5] In upholding Wyoming's taxation of mail-order insurers, the Wyoming Supreme Court recently has recognized that the claims procedure is "a hugely important aspect of any insurance business." *Armed Forces Co-Op., etc. v. Dept. of Ins.* (1980) Wyo., 622 P.2d 1318, 1345, *appeal dismissed* (1982) 454 U.S. 1130. The constitutional importance of whether any claims investigation is carried out in the taxing state is emphasized by the specific mention of the *absence* of such activities in cases where this United State Supreme Court has *denied* a state's jurisdiction to tax insurers. *See, e.g., Connecticut General Life Ins. Co. v. Johnson* (1938) 303 U.S. 77, 82; *State Bd. of Ins. v. Todd Shipyards* (1962) 370 U.S. 451, 454-55.

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5 Appellant several times (J.S. 7, 19, 20) refers to the California tax as a "gross receipts" tax; therefore it should be emphasized that the tax is a *privilege* tax which is only measured by gross premiums from California insureds. "It is not a gross receipts tax" of the sort that would include in its measure all other types of income an insurer might have. *Equitable Life etc. Soc. v. Johnson* (1942) 53 Cal.App.2d 49, 58, 127 P.2d 95, 99. Appellant is not now challenging the California Supreme Court's holding that, once jurisdiction is established, it was proper to include all premiums received from California insureds in the measure of the tax. 34 Cal.3d at 852-55; J.S. App. A, A-16-A-20.

Appellant National Liberty's attempt to brand its California claims investigations activities as insignificant must fail. Contrary to appellant's arguments (J.S. 11), the California Supreme Court has not surreptitiously applied a "slightest presence" test in correctly holding that the integral and crucial claims investigations of National Liberty's California representatives serve to distinguish this case from *National Bellas Hess.* 34 Cal.3d at 849-50; J.S. App. A, A-11 - A-13.

II. Scripto v. Carson authorizes attributing in-state activities of independent contractors to sellers from outside the taxing state.

Appellant National Liberty attempts to rewrite *Scripto v. Carson* (1960) 362 U.S. 207 so that its holding would only apply when an out-of-state seller had attempted to disguise de facto employees by giving them a sham designation as "independent contractors". See J.S. 12-14. To the contrary, the following excerpts from the *Scripto* opinion indicate that this Court accepted the representatives in that case as true independent contractors:

> "[T]he 'salesmen' are not regular employees of appellant devoting full time to its service, but we conclude that such a fine distinction is without constitutional significance. . . . [W]e cannot see, from a constitutional standpoint, 'that it was important that the agent worked for several principals.' . . . The test is simply the nature and extent of the activities of the appellant in Florida." *Id.* at 211-12.

There is no basis in *Scripto* or in logic that would limit the *Scripto* attribution rule only to independent contractors who solicit sales; as noted by the California Supreme Court, under *Scripto* any California activities of

National Liberty's independent contractors should be weighed as if they had been conducted by employees. See 34 Cal.3d at 849, J.S. App. A, A-11 - A-12. (See discussion above at pp. 6-8 regarding the significance here of the type of California contracts made by National Liberty's independent contractors.)

III. <u>Miller Bros. v. Maryland,</u> which involved only totally out-of-state purchases, is clearly distinguishable.

Appellant National Liberty refers to the California Supreme Court's distinguishing of *Miller Bros. Co. v. Maryland* (1954) 347 U.S. 340 as "[p]articularly egregious" (J.S. 15); yet it appears that the California Supreme Court has distinguished *Miller Bros.* on the same basis utilized by this Court in *Scripto v. Carson, supra,* and *National Geographic v. Cal. Equalization Bd.* (1977) 430 U.S. 551. As pointed out by the California Supreme Court, *Miller Bros.* involved "purchases made in foreign state". 34 Cal.3d at 851; J.S. App. A, A-15. In *Miller Bros.* this Court rejected Maryland's jurisdiction to tax, noting that "[t]he liability arises only because of a Delaware sale and is measured by its proceeds." 347 U.S. at 344. As pointed out by this Court in *Miller Bros.,* in that case there was "no invasion or exploitation of the consumer market in Maryland." *Id.* at 347. In *Scripto,* the *Miller Bros.* decision was distinguished in part on the basis that in *Miller Bros.* the purchases were made by Maryland residents when personally present in Delaware: "there was no 'exploitation of the consumer market'; no regular, systematic displaying of its products by catalogs, samples or the like." 362 U.S. at 212. In *National Geographic,* a

mail-order sales case, this Court distinguished *Miller Bros.* on the same ground, citing *Scripto.* 430 U.S. at 559.

In the case at bar there can be no doubt that National Liberty exploited the local insurance market in California. During the three years in issue in this case National Liberty sent 3,460,882 solicitations to prospective California insureds. Stip. ¶ 66.[6] In terms of exploiting the California market, those solicitations occurred in California: "[R]ealistically viewed the insurer through the instrumentality of the mail is for all practical purposes soliciting insurance here as manifestly as if it were to carry on such solicitation through representatives physically present within this state." *People v. United National Life Ins. Co.* (1967) 66 Cal.2d 577, 593, 58 Cal.Rptr. 599, 609, 427 P.2d 199, 209, *appeal dismissed* 389 U.S. 330 (in which National Liberty was one of several mail-order insurers held to be subject to California insurance regulation).[7]

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6 The highest California population figure for these years was 18,464,000 in 1965. 1981 California Statistical Abstract, p. 13. Thus during this three-year period it might be expected that one out of every five or six Californians was directly solicited by mail by National Liberty. In 1965 National Liberty insured 20,323 California citizens (Stip. ¶ 59); that figure is greater than the 1965 population of one out of every four California *counties*. 1966 California Statistical Abstract, p. 12. Furthermore, an undetermined number of the National Liberty mail solicitations included an actual policy which the California resident could accept in California by mailing a validation certificate back to National Liberty. Stip. ¶ 33, Exh. K.

7 In *National Bellas Hess* this Court held that conducting a general business solely by mail or common carrier could not by itself give taxing jurisdiction. There was no holding that mail-order solicitation had no constitutional significance at all. Moreover, in an insurance tax case such as this, in which only the due process clause but not the

(Continued on following page)

In addition to its broad exploitation of the California market through the mails and advertising in national magazines, National Liberty also conducted some California radio advertising and advertised in several dozen California newspapers. Stip. ¶¶ 28-29, 61, 63-65. In fact, magazine, radio and newspaper advertising yielded approximately 39% of the applications which came from California in 1965. Stip. ¶ 61.

It is respectfully submitted that under the above facts the California Supreme Court was fully justified in distinguishing the *Miller Bros.* decision on the basis that *Miller* did not involve true invasion or exploitation of the taxing state's market.

IV. The result below does not automatically apply to mail-order sellers other than insurers.

Although the California Supreme Court has held that the same due process *standards* apply to insurers as apply to other types of businesses (34 Cal. 3d at 846-47; J.S. App. A, A-6 - A-9), that does not constitute a holding that any in-state follow-up activity after any mail-order sale of merchandise will give constitutional nexus to tax. In this case the California Supreme Court applied the standard due process tests and based its jurisdictional holding on its recognition that claims investigation activities are an

(Continued from previous page)

commerce clause is applicable (see note 2 above), weight should be given to all activities carried on within the state even if some of those activities are accomplished by means of instrumentalities of interstate commerce. In this respect it is interesting that appellant National Liberty relies upon the interstate deliveries in *Miller Bros.* as substantial ancillary activities. J.S. 15, 16.

integral and crucial part of the *insurance* business. 34 Cal.3d at 849, 850, 854; J.S. App. A, A-12, A-13, A-20. In other businesses where the sale of goods is the primary object, the importance of any in-state follow-up activities will have to be independently weighed. Furthermore, even if the identical due process standards apply to insurers and sellers of goods, taxation of activities involving the sale of goods will also have to meet the tests of the commerce clause: the facts of other cases may result in a tax being valid under the due process clause and yet the tax may fall before the commerce clause. See Hartman, "State Taxation of Interstate Commerce: A Survey and an Appraisal", 46 Va. L. Rev. 1051, 1061-62 (1960); also see notes 2 and 7 above.

V. This Court recently has rejected another appeal which presented the same issue.

The California Supreme Court discusses three decisions from other jurisdictions where "the power of a state to tax mail order insurers was upheld even though the activities of the insurers in the taxing state were similar to or less extensive than those of plaintiffs." 34 Cal.3d at 850-51; J.S. App. A, A-12 - A-15. All three of these decisions (one involving National Liberty) were presented to this Court, and this Court declined to review all three. *Ministers Life & Casualty Union v. Haase* (1966) 30 Wis.2d 339, 141 N.W.2d 287, *appeal dismissed* 385 U.S. 205; *National Liberty Life Ins. Co. v. State of Wisconsin* (1974) 62 Wis.2d 347, 215 N.W.2d 26, *cert. denied and appeal dismissed* (1975) 421 U.S. 940, 946; *Armed Forces Co-Op., etc. v. Dept. of Insurance* (1980) Wyo., 622 P.2d 1318, *appeal dismissed* (1982) 454 U.S. 1130. Thus this Court's

latest exposure to this issue was in 1982 in the *Armed Forces Co-Op.* case, wherein the Wyoming Supreme Court had held that Wyoming had due process jurisdiction to tax and regulate a Kansas insurer who had considerably less overall contacts with Wyoming than National Liberty has with California in the case at bar. It is respectfully submitted that no constitutionally significant differences are presented in the current case which would give cause for this Court's now giving plenary consideration to the issue.

CONCLUSION

For the reasons given above, it is respectfully submitted that this Court should dismiss the appeal or, in the alternative, affirm the decision of the California Supreme Court.

DATED: March 16, 1984.

Respectfully submitted,

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No. 83-1251

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1983

NATIONAL LIBERTY LIFE INSURANCE COMPANY,
Appellant,

vs.

STATE BOARD OF EQUALIZATION,
Appellee.

On Appeal From The Supreme Court of the State of California

BRIEF IN OPPOSITION TO MOTION TO DISMISS OR AFFIRM

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BRIEF IN OPPOSITION TO MOTION TO DISMISS OR AFFIRM

In its Motion to Dismiss or Affirm, at 8-9, Appellee agrees that the decision below rests upon an interpretation of *Scripto Inc. v. Carson,* 362 U.S. 207 (1960), which would, for purposes of determining constitutional jurisdiction to tax, permit California to treat *any* in-state activities of ***true independent contractors*** as if they were activities of an out-of-state company's employees. This far-reaching construction of *Scripto,* unsupported by the decision itself or any other authority, was necessary for the court below to conclude that California had taxing jurisdiction. Relying upon this erroneous interpretation, Appellee goes on to urge summary dismissal or affirmance of this appeal based upon the alleged variety and magnitude of Appellant's contacts with the state and this Court's prior refusal to consider three cases involving related issues. It is these points which Appellant's Brief in Opposition seeks to clarify.[1]

Regarding Appellant's contacts with California, it is critical to recognize that the alleged multitude of National Liberty's "representatives" within California cited by Appellee is in fact limited to a few commercial relationships with true independent contractors, who performed occasional services of a type routinely utilized by out-of-state concerns. It is true that Retail Credit Company, an independent nationwide organization, was engaged occasionally to collect claims information through its various offices and employees; in some cases doctors *of insured parties* were also asked to supply medical records directly

[1]Appellant National Liberty states pursuant to Rule 28.1 that the Designation of Corporate Relationships filed as Appendix D to Appellant's Jurisdictional Statement is currently accurate.

to Appellant; and California lawyers were hired to defend against one claimant's suit and to advise Appellant from time to time on California regulatory law. However, business contacts of this type are akin to the use of Dun & Bradstreet for credit checks, an "integral" function of many out-of-state businesses having California customers; reaching such businesses would represent a significant expansion of state taxing power. Moreover, predicating tax jurisdiction upon retention of legal counsel to defend a civil action equates constitutional jurisdiction to tax with that for subjecting an out-of-state concern to service of process, another novel result unsupported by case law.

Beyond National Liberty's engagement of these true independent contractors, Appellee can only emphasize the volume of Appellant's mail solicitation of California residents. However, Appellee's reliance on this contact and the "market exploitation" theory espoused by the *dissent* in *National Bellas Hess, Inc. v. Department of Revenue,* 386 U.S. 753 (1967) is clearly misplaced, given the conclusion reached by the *majority* in that case where a similar number of solicitations was present.

Appellee attempts to bolster its argument for summary disposition by reference to this Court's "declin[ing] to review" three prior insurance cases. *Ministers Life & Casualty Union v. Haase,* 30 Wis. 2d 339, 141 N.W.2d 287, *appeal dismissed,* 385 U.S. 205 (1966); *National Liberty Life Ins. Co. v. State,* 62 Wis. 2d 347, 215 N.W.2d 26 (1974), *cert. denied and appeal dismissed,* 421 U.S. 940, 946 (1975); *Armed Forces Cooperative Insurance Ass'n. v. Department of Insurance,* 622 P.2d 1318, (Wyo. 1980), *appeal dismissed,* 454 U.S. 1130 (1982). *Ministers Life* and *Armed Forces* are distinguishable from this case *inter alia* for the reasons

set forth at page 19 of Appellant's Jurisdictional Statement. As to the Wisconsin case involving National Liberty, dismissal of appeal hinged solely upon this Court's denial of a certiorari petition filed by the state (which had lost the case on an apportionment issue); the Court's dismissal was based upon its denial of certiorari and indicated nothing as to the merits of Appellant's contentions on a mooted issue. 421 U.S. 940.

Accordingly, this is a case of first impression, which involves an unprecedented expansion of the states' constitutional jurisdiction to tax under the aegis of *Scripto,* a case this Court has since referred to as "the furthest constitutional reach to date of a State's [taxing] power." *National Bellas Hess,* 386 U.S. at 757. The implications of the California court's approach are enormous, not only for the insurance industry but for all interstate businesses relying upon due process protection against extraterritorial taxation.

CONCLUSION

For the foregoing reasons, the Motion to Dismiss or Affirm should be denied and this Court should note probable jurisdiction and grant plenary consideration of this appeal.

Dated: March 23, 1984

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